Office-Supreme Court, U.S.
FILED
MAY 12 1981
ALEXANDER L. STEVAS,
CLERK

80-1903

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. ____

WM. ROBERT WHITTAKER,

Petitioner,

v.

WHITTAKER CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

WILLIAM THOMPSON BISSET
515 South Flower Street
Los Angeles, California 90071
(213) 489-5140
Attorney for Petitioner

Of Counsel:
HUGHES HUBBARD & REED
JOHN J. KRALIK, IV
515 South Flower Street
Los Angeles, California 90071

PANDICK PRESS, WEST COAST, 1945 S. FIGUEROA, LOS ANGELES, CALIFORNIA (213) 747-4321

Petitioner Wm. Robert Whittaker respectfully petitions for a writ of certiorari to review certain portions of the judgment of the United States Court of Appeals for the Ninth Circuit entered in this case on February 12, 1981, affirming in part and reversing in part the judgment of the United States District Court for the Central District of California entered on April 7, 1977.

QUESTIONS PRESENTED

1. Whether respondent's notice of appeal filed more than 30 days after entry of judgment but less than 30 days after the district court's denial of respondent's post-judgment motion to retax costs was untimely and therefore insufficient to confer jurisdiction on the court of appeals.

2. Whether, on the court of appeals' "attribution" theory, petitioner is liable under § 16(b) of the Securities Exchange Act of 1934 ("§ 16(b)") for "profit realized" by his mother from securities transactions that he managed for her.

3. Whether, despite the district court's finding that respondent was at all times on notice of the facts underlying its § 16(b) claim, petitioner's failure to list his mother's transactions on forms that he filed with the SEC tolled § 16(b)'s two-year statute of limitations that, but for tolling, would bar respondent's claim.

4. Whether Congress intended § 16(b) to create strict liability for "profit" calculated according to a "lowest in highest out" formula.

TABLE OF CONTENTS

PAGE

QUESTIONS PRESENTED i
TABLE OF AUTHORITIES iii
OPINIONS BELOW 1
JURISDICTION 1
CONTROLLING RULES AND STATUTES 2
STATEMENT OF THE CASE 2
JURISDICTION IN THE DISTRICT COURT 4
REASONS FOR GRANTING THE WRIT 4
Lack of Appellate Jurisdiction 4
Undue Expansion of Section 16(b) 5
I. THE CORPORATION'S NOTICE OF APPEAL WAS UNTIMELY 6
II. CONTRARY TO CONGRESS' INTENT AND THIS COURT'S INTERPRETIVE GUIDELINES, THE DECISION BELOW UNDULY BROADENS § 16(b)'S EXTRAORDINARY LIABILITY WITHOUT FAULT AND UNDULY NARROWS § 16(b)'S RESTRICTIONS ON SUCH LIABILITY 9
A. The Court of Appeals' Decision "Attributing" to Mr. Whittaker His Mother's Purchases and Sales of Securities Departs from the Words of § 16(b) and Conflicts with Principles Established by this Court in *Blau v. Lehman* and Subsequent Cases 9
B. The Court of Appeals' Ruling that § 16(b)'s Two-Year Statute of Limitations Was Tolled Conflicts Directly with the Holding in *Carr-Consolidated Biscuit Co. v. Moore*, with the Legislative Scheme Enacted by Congress in 1934 and with Principles of Interpretation Set Forth in this Court's Recent Opinions Construing the Federal Securities Laws 13
C. Calculating Liability for "Profit Realized" by Mechanically Applying a Fictional "Lowest In Highest Out" Formula, Regardless of the Circumstances, Penalizes Mr. Whittaker and Other Insiders who Innocently Fall Victim to § 16(b)'s Trap for the Unwary 16
CONCLUSION 20

TABLE OF AUTHORITIES

CASES	PAGE
Alameda v. Paraffine Cos., 169 F.2d 408 (9th Cir. 1948)	6
Allis-Chalmers Manufacturing Co. v. Gulf & Western Industries, Inc., 527 F.2d 335 (7th Cir. 1975), *cert. denied*, 424 U.S. 928 (1976), *aff'g in part, rev'g in part* 372 F. Supp. 570 (N.D. Ill. 1974)	16, 17
Altamil Corp. v. Pryor, 405 F. Supp. 1222 (S.D. Ind. 1975)	10
American Standard, Inc. v. Crane Co., 510 F.2d 1043 (2d Cir 1974), *cert. denied*, 421 U.S. 1000 (1975)	13
Anderson v. Commissioner, 480 F.2d 1304 (7th Cir. 1973)	17
Blau v. Lehman, 368 U.S. 403 (1962)	5, 9, 10, 16
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	15
Carr-Consolidated Biscuit Co. v. Moore, 125 F. Supp. 423 (M.D. Pa. 1954)	13, 15
Curtis v. Connly, 257 U.S. 260 (1921)	14
Department of Water & Power v. Allis-Chalmers Manufacturing Co., 213 F. Supp. 341 (S.D. Cal. 1963)	16
Environmental Defense Fund, Inc., v. Froehlke, 368 F. Supp. 231 (W.D. Mo. 1973), *aff'd sub nom. Environmental Defense Fund, Inc. v. Callaway*, 497 F.2d 1340 (8th Cir. 1974)	7
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976)	15, 16
Foremost-McKesson, Inc. v. Provident Securities Co., 423 U.S. 232 (1976)	5, 13, 19
Fowler v. Hamill, 139 U.S. 549 (1891)	7
FTC v. Minneapolis-Honeywell Regulator Co., 344 U.S. 206 (1952)	8, 9
Heminway v. Commissioner, 44 T.C. No. 96 (Apr. 23, 1965)	11
Hill v. Hawes, 320 U.S. 520 (1944)	6
Holmberg v. Armbrecht, 327 U.S. 392 (1946)	16
Kern County Land Co. v. Occidental Petroleum Corp., 411 U.S. 582 (1973)	5
Knowles v. United States, 260 F.2d 852 (5th Cir. 1958)	6, 7, 8

CASES PAGE

Korn v. Merrill, 403 F. Supp. 377 (S.D.N.Y. 1975), *aff'd*, 538 F.2d 310 (2d Cir. 1976) 14
Lewis v. Varnes, 505 F.2d 785 (2d Cir. 1974) 13
Marquette Cement Manufacturing Co. v. Andreas, 239 F. Supp. 962 (S.D.N.Y. 1965) 11
Maryland Casualty Co. v. Jacobson, 37 F.R.D. 427 (W.D. Mo. 1965) 8
Nichols v. Commissioner, 14 B.T.A. 1347 (1929) 11
Portnoy v. Kawecki Berylco Industries, Inc., 607 F.2d 765 (7th Cir. 1979) 13
Provident Securities Co. v. Foremost-McKesson, Inc., 506 F.2d 601 (9th Cir. 1974), *aff'd*, 433 U.S. 232 (1976) 19
Reliance Electric Co. v. Emerson Electric Co., 404 U.S. 418 (1972) 5, 14
Ross v. United States, 122 F. Supp. 642 (D. Mass. 1954) 11
SEC v. Sloan, 436 U.S. 103 (1978) 15
United States v. 2,186.63 Acres, 464 F.2d 676 (10th Cir. 1972). 7
Whiting v. Dow Chemical Co., 523 F.2d 680 (2d Cir. 1975), *aff'g* 386 F. Supp. 1130 (S.D.N.Y. 1974) 10

STATUTES

Securities Act of 1933, § 5, 15 U.S.C. § 77(e) 16
Securities Act of 1933, § 12(1), 15 U.S.C. § 77*l*(1) 16
Securities Act of 1933, § 13, 15 U.S.C. § 77m 16
Securities Exchange Act of 1934, § 9(e), 15 U.S.C. § 78i(e) 15
Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b) 10, 19
Securities Exchange Act of 1934, § 16(a), 15 U.S.C. § 78p(a) .. 2
Securities Exchange Act of 1934, § 16(b), 15 U.S.C. § 78p(b) ..... *passim*
Securities Exchange Act of 1934, § 18(c), 15 U.S.C. § 78r(e) ... 15
Securities Exchange Act of 1934, § 27, 15 U.S.C. § 78aa 4
28 U.S.C. § 1254(1) 1
28 U.S.C. § 1331 4

RULES — PAGE

Fed. R. App. P. 4(a) 2, 4, 6
Fed. R. Civ. P. 52(b) 7
Fed. R. Civ. P. 54(d) 2, 4, 6, 7
Fed. R. Civ. P. 58 8
Fed. R. Civ. P. 59(a) 7
Fed. R. Civ. P. 59(e) 2, 4, 6, 7
Fed. R. Civ. P. 73(a), 335 U.S. 933-34 (1948), *replaced by* Fed. R. App. P. 4(a) (1966) 6
Rule 10b-5, 17 C.F.R. § 240.10b-5 19

LEGISLATIVE HISTORY

§ 15(b) of S. 2642 and H.R. 7852, 73d Cong., 2d Sess. (1934). 17
Hearings on S. 84, 56 and 97 Before the Senate Committee on Banking and Currency, 73 Cong., 2d Sess. 6557-59 (1934) ... 17
Hearings on H.R. 4344, 5065 and 5832 Before the House Committee on Interstate and Foreign Commerce, 77 Cong., 1st sess. 1255 (1942) 19

OTHER AUTHORITIES

12 C. Wright & A. Miller, *Federal Practice & Procedure: Civil* (1973) 6
J. Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats"*, 52 Cornell L.Q. 69 (1966) 17, 18
W. Painter, *The Evolving role of Section 16(b)*, 62 Mich. L. Rev. 649 (1964) 17, 18
Comment, *"Beneficial Ownership" Under Section 16(b) of the Securities Exchange Act of 1934*, 77 Colum. L. Rev. 446 (1977) 10
Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592 (1974) 17, 19
Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. Rev. 1289 (1973) 17, 19

IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

No. ____

WM. ROBERT WHITTAKER,

Petitioner,

v.

WHITTAKER CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

OPINIONS BELOW

The opinion of the court of appeals is reported at 639 F.2d 516. The unpublished opinion of the district court is reprinted at [1977-78 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 96,008. These opinions are set out in Appendices A and B.

JURISDICTION

The judgment of the court of appeals was entered on February 12, 1981. This Court has jurisdiction to review the judgment of the court of appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

CONTROLLING RULES AND STATUTES

The controlling rules on jurisdiction are Fed. R. Civ. P. 54(d) and 59(e) and Fed. R. App. P. 4(a). The controlling statutes on the merits are §§ 16(a) and (b) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78p(a) and (b)) ("§ 16(a)" and "§ 16(b)"). These rules and statutes are set out in Appendix C.

STATEMENT OF THE CASE

Petitioner Wm. Robert Whittaker ("Mr. Whittaker") founded Respondent Whittaker Corporation ("the Corporation") in the 1940's. His parents lent money to the fledgling enterprise and became 35% shareholders [App. at B-2]. By the end of the 1950's, the Corporation had prospered, and both Mr. Whittaker and his mother, by then a widow, had become independently wealthy through their ownership of the stock of a predecessor of the Corporation. In 1959, because of the increased complexity of the task, Mr. Whittaker began managing his mother's investment portfolio and handling her financial affairs pursuant to a general power of attorney [App. at B-4].[1] At all relevant times, Mr. Whittaker and his mother maintained separate households, each paying his or her expenses with his or her own money.

In March 1965, after a period of rapid growth through a series of acquisitions and mergers, the officers and directors of the Corporation first became subject to the insiders' reporting requirements of § 16(a). The Corporation delegated responsibility for assuring compliance with such requirements to its chief legal counsel, who then and thereafter arranged for appropriate reports for each insider to be prepared and filed with the SEC and for advisory memoranda to be circulated to each insider [App. at B-2-3].

[1] In the early 1960's, Mr. Whittaker acquired a substantial portion of his mother's holdings in the predecessor of the Corporation and gave his promissory notes in return. At the time of trial, Mr. Whittaker's outstanding notes to his mother in the amount of $767,436 represented more than half her net worth [App. at B-5].

Throughout the late 1960's and early 1970's,[2] Mr. Whittaker regularly sold small portions of his own founder's stock, in effect using his securities as currency to supplement his cash flow. Although he bought none of the Corporation's securities for himself during the relevant trading period, he did buy and sell certain such securities (principally, convertible debentures) for his mother in transactions that he did not include on the forms that he filed with the SEC [App. at B-5-6]. The district court found that he had openly disclosed his mother's and his own transactions, orally and in writing, within the Corporation, and that the Corporation was at all times on notice of its potential § 16(b) claim [App. at B-16-17].

In January 1971, the Corporation advised Mr. Whittaker that if his mother's transactions could be "attributed" to him and consolidated with his own transactions, he would have substantial § 16(b) liability. Subject to his reserved right to bring an action to obtain a judicial declaration of his actual liability, if any, and to recover whatever had been overpaid [App. at B-1], Mr. Whittaker paid the Corporation the total amount of its maximum potential claim—$495,222.

Trial was held in the United States District Court for the Central District of California in October-November 1976 before the Honorable Laughlin E. Waters. In an opinion filed March 22, 1977, the district court broadly interpreted § 16(b) so as to cover the transactions that Mr. Whittaker managed for his mother. The district court also ruled that Mr. Whittaker was entitled to rely on § 16(b)'s two-year statute of limitations to bar part of the Corporation's claim. It found as a fact that the Corporation was on notice at all times of any potential § 16(b) claim against Mr. Whittaker and, accordingly, held that the Corporation could not properly invoke any federal tolling doctrine. In upholding Mr. Whittaker's statute-of-limitations defense, the district court ordered the Corporation to return the moneys that it had collected from him in respect of transactions completed more than two years before the Corporation first made its demand.

---

[2] The transactions at issue in this litigation occurred between December 1, 1965, and December 31, 1970 ("the relevant trading period").

Judgment was entered on April 7, 1977. In contravention of Fed. R. App. P. 4(a), which allows only 30 days from the date of entry of judgment within which to appeal, the Corporation failed to file its notice of appeal until May 18, 1977. Over Mr. Whittaker's objection, the district court ordered its clerk to accept the Corporation's notice of appeal for filing, ruling that the Corporation's post-judgment motion to retax costs had extended its time for appeal. The United States Court of Appeals for the Ninth Circuit subsequently denied Mr. Whittaker's motion to dismiss the Corporation's appeal for want of jurisdiction; and, on the merits of the Corporation's appeal and Mr. Whittaker's cross-appeal, affirmed the district court's "attribution" theory of § 16(b) liability but reversed its ruling that Mr. Whittaker could rely on § 16(b)'s two-year statute of limitations. Mr. Whittaker's resulting liability is greater than that imposed on any individual insider in any reported decision of which we are aware.

JURISDICTION IN THE DISTRICT COURT

Jurisdiction in the district court was premised on § 27 of the Securities Exchange Act of 1934 (15 U.S.C. § 78aa) and 28 U.S.C. § 1331.

REASONS FOR GRANTING THE WRIT

Lack of Appellate Jurisdiction

At the outset this petition raises the procedural issue whether the making of a post-judgment motion to retax costs extends the time to invoke federal appellate jurisdiction. Resolution of the issue requires analysis of the text and policy of Fed. R. Civ. P. 54(d) and 59(e) and Fed. R. App. P. 4(a). We respectfully submit that the issue is important enough to warrant this Court's review because the basic limits of appellate jurisdiction and the principle that litigation must end at some

definite point in time are at stake. We believe that the decision below conflicts with important principles established by this Court and with a holding of the United States Court of Appeals for the Fifth Circuit.

Undue Expansion of Section 16(b)

This petition also raises a group of substantive issues involving the proper construction of § 16(b). These issues can broadly but fairly be stated to be whether the words of § 16(b), interpreted literally, set the outer boundaries of the statute's extraordinary liability without fault or whether such liability extends beyond the statute's literal terms.

Because customary guidelines of morality and good faith afford no protection against § 16(b)'s potential for imposing enormous liability without fault, we submit that insiders should not have to run the risk that courts will interpret the language of the statute in light of its general anti-insider purpose so as to reach transactions not squarely covered. The decision below creates uncertainty that will touch tens (and probably hundreds) of thousands of individual insiders (officers, directors and 10% owners) of the thousands of public companies that are subject to the federal securities laws and turn § 16(b) into even more of a trap for the unwary than it already is.

This Court has rendered four opinions on the merits interpreting § 16(b).[3] All were cases limiting the § 16(b) liability of business enterprises (*i.e.*, partnerships and corpo-

[3] *Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 249-52 (1976) (no liability because more-than-10% stockholder literally was not such "both at the time of the purchase and sale;" *held:* status must be determined *before*, not simultaneously with, the purchase); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (no liability because involuntary exchange was not a "sale"); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422-23 (1972) (no liability because more-than-10% stockholder literally was not such "both at the time of the purchase and sale;" *held:* no liability for sale made after insider reduced his ownership below 10% in order to avoid § 16(b)); *Blau v. Lehman*, 368 U.S. 403, 414 (1962) (the most critical precedent; *held:* insider potentially liable only for profit realized *by him*).

rations) that themselves were corporate insiders. Individual insiders now need guidance from the Court concerning their potential § 16(b) liability for securities transactions of their parents, spouses, offspring, relatives, associates and friends.

The decision below conflicts, at least in principle, with this Court's decisions requiring strict and literal interpretation of the federal securities laws generally and § 16(b) particularly. It also conflicts in important respects with reported decisions of other federal courts.

I.

THE CORPORATION'S NOTICE OF APPEAL WAS UNTIMELY

The Corporation filed its notice of appeal more than 30 days after judgment was entered. Nevertheless, the court of appeals denied Mr. Whittaker's motion to dismiss on the ground that the Corporation's post-judgment motion to retax costs should be regarded as a motion to "alter or amend the judgment" under Fed. R. Civ. P. 59(e) for purposes of extending the time for appeal under Fed. R. App. P. 4(a). In fact, however, the Corporation's post-judgment motion, both in caption and in substance, was a motion to retax costs under Fed. R. Civ. P. 54(d), the making of which did not extend the time for appeal.

The court of appeals' ruling upholding jurisdiction directly conflicts with the Fifth Circuit Court of Appeals' decision in *Knowles v. United States,* 260 F.2d 852 (5th Cir. 1958).[4] *See*

[4] The court of appeals followed its early decision in *Alameda v. Paraffine Cos.,* 169 F.2d 408 (9th Cir. 1948), a case akin to *Hill v. Hawes,* 320 U.S. 520 (1944), both of which were overruled by the 1948 amendment to Fed. R. Civ. P. 73(a) [the predecessor of Fed. R. App. P. 4(a)]. 335 U.S. 933-34 (1948). *See* the Advisory Committee's Note, which is reprinted in 12 C. Wright & A. Miller, *Federal Practice & Procedure: Civil,* at 542 (1973).

also Fowler v. Hamill, 139 U.S. 549 (1891) (entry of second judgment specifically including amount of costs does not extend time for filing notice of appeal from original judgment); *Environmental Defense Fund, Inc. v. Froehlke,* 368 F. Supp. 231, 251-53 (W.D. Mo. 1973), *aff'd sub nom., Environmental Defense Fund, Inc. v. Callaway,* 497 F.2d 1340 (8th Cir. 1974) (motion to retax costs arises under Fed. R. Civ. P. 54(d) and not Fed. R. Civ. P. 59(e)). *But see also United States v. 2,186.63 Acres,* 464 F.2d 676, 677 (10th Cir. 1972) (motion to retax costs was styled "motion to amend judgment").

In *Knowles,* judgment was entered on September 19, 1957. Appellant moved for a new trial under Rule 59(a), for additional findings of fact and conclusions of law under Rule 52(b) and for vacation of the court's order directing the clerk to tax costs against appellant.[5] On December 20, 1957, the district court denied appellant's Rule 59(a) and Rule 52(b) motions. On January 28, 1958, the district court denied appellant's motion to vacate the order directing taxation of costs. On February 19, 1958 (more than 60 days after denial of appellant's Rule 59(a) and Rule 52(b) motions but less than 60 days after denial of appellant's retaxation-of-costs motion), appellant filed her notice of appeal from each of the district court's rulings. The Fifth Circuit, after having "carefully considered each of the excuses presented by the appellant and her asserted grounds for preserving this Court's jurisdiction," dismissed the appeal from the district court's December 20

[5] In the case at bar, the court of appeals mistakenly distinguished *Knowles* in part on the ground that Ms. Knowles' motion to retax challenged only two items of cost. 639 F.2d at 521 n.2. In fact, the post-judgment motion in *Knowles* was to vacate the *entire* award of costs (which happened to consist of only two items) on the ground that the Fifth Circuit's local rule forbade any award of costs for or against the United States. 260 F.2d at 854.

rulings as being one day late,[6] but upheld the timeliness of the appeal from, and indeed reversed, the district court's January 28 ruling on costs. 260 F.2d at 854.[7]

The dual principles underlying the decision in *Knowles* were set forth by this Court in *FTC v. Minneapolis-Honeywell Regulator Co.:* that "litigation must at some definite point be brought to an end" and, therefore, that those federal rules of civil procedure that sometimes extend the time to appeal "are not to be applied so as to permit tolling because some event occurred in the lower court after judgment was rendered which is of no import to the matters to be dealt with on review." 344 U.S. 206, 213 (1952). In *Minneapolis-Honeywell*, respondent appealed to the court of appeals from each of three district court determinations but then abandoned its appeal from two of the three. On July 5, the court of appeals reversed the third determination. On August 21, the FTC by motion asked the court of appeals to clarify that the other two determinations of the district court still stood. On September 18, the court of appeals entered a second order restating its prior reversal of the one determination and confirming the validity of the other two. On December 14 (more than 90 days after the July 5 order but less than 90 days after the September 18 order), the FTC petitioned for certiorari.

---

[6] Since the United States was a party, appellant had 60 days from entry of judgment within which to notice her appeal.

[7] As the court of appeals noted in the case at bar, the motion to retax in *Knowles* related to costs assessed in connection with a prior appeal. The distinction that the court of appeals attempted to draw was that the challenged costs in *Knowles* were "separate from" the merits of the judgment from which appellant appealed. However, it is the very "separateness" of entry of judgment and award of costs in *all* cases that clearly shows why no post-judgment motion to retax costs should affect the finality of a judgment on the merits or the running of the time to appeal therefrom. *See, e.g.*, Fed. R. Civ. P. 58 ("Entry of judgment shall not be delayed for the taxing of costs."); *Maryland Cas. Co. v. Jacobson*, 37 F.R.D. 427, 430 (W.D. Mo. 1965) ("questions relating to the taxation of costs . . . are not to be confused with questions that relate to the merits of an appeal").

The Court dismissed the petition as untimely:

> "[W]e cannot hold that the time for filing a petition for certiorari was enlarged simply because this paper [*i.e.*, the FTC's post-judgment motion] may have prompted the court below to take some further action which had no effect on the merits of the decision that we are now asked to review in the petition for certiorari."

344 U.S. at 211.

So too here, the Corporation's post-judgment motion to retax costs raised a matter clearly collateral to the merits of the judgment subsequently reviewed by the court of appeals. The court of appeals' ruling that the making of the motion to retax costs extended the Corporation's time to appeal conflicts with the principles applied in *Minneapolis-Honeywell* and therefore must be overturned.

II.

CONTRARY TO CONGRESS' INTENT AND THIS COURT'S INTERPRETIVE GUIDELINES, THE DECISION BELOW UNDULY BROADENS § 16(b)'S EXTRAORDINARY LIABILITY WITHOUT FAULT AND UNDULY NARROWS § 16(b)'S RESTRICTIONS ON SUCH LIABILITY

A. The Court of Appeals' Decision "Attributing" to Mr. Whittaker His Mother's Purchases and Sales of Securities Departs from the Words of § 16(b) and Conflicts with Principles Established by this Court in *Blau v. Lehman* and Subsequent Cases

The court of appeals held that Mr. Whittaker's mother's securities transactions must be "attributed" to him for § 16(b) purposes because he was in a position to "benefit" from them. It further held that profits "realized" by matching either Mrs. Whittaker's purchases and sales of stock and convertible deben-

tures or by matching Mr. Whittaker's sales of stock and his mother's purchases of stock and convertible debentures are "profits realized by him" as that phrase is used in § 16(b). This holding conflicts with principles of interpretation set forth in *Blau v. Lehman*, 368 U.S. 403 (1962) (strictly and literally interpreting "profit realized by him" in the context of a partnership and disapproving "attribution" of § 16(b) profit), and subsequent cases construing § 16(b) and other federal securities laws. As the Court said in *Blau v. Lehman*, "[§ 16(b)] leaves no room for judicial doubt that a director is to pay to his company only 'any profit realized *by him*' from short-swing transactions." 368 U.S. at 414 (emphasis in original). The case at bar and two previously-decided cases involving "attribution" to insiders of their spouses' profits[8] have expanded § 16(b)'s "extraordinary liability"[9] beyond the limits fixed by Congress and have left insiders and their families, friends, associates and advisors with insufficient guidance as to the scope of potential liability. *See* Comment, *"Beneficial Ownership" Under Section 16(b) of the Securities Exchange Act of 1934*, 77 Colum. L. Rev. 446, 453-60 (1977) (sharply criticizing the district court decision in this case and the *Whiting* and *Altamil* decisions on which it was based). An insider may "benefit" in some sense, now or in the future, directly or indirectly, when someone whom he knows or someone whose portfolio he manages trades his company's securities.[10] Such "benefit", however, is not "profit realized by him" within the meaning of § 16(b).

---

[8] *Whiting v. Dow Chem. Co.*, 523 F.2d 680 (2d Cir. 1975), *aff'g* 386 F. Supp. 1130 (S.D.N.Y. 1974); *Altamil Corp. v. Pryor*, 405 F. Supp. 1222 (S.D. Ind. 1975). Because the law regards the spousal relationship in many respects to be *sui generis*, we submit that the previously-unprecedented extension of the theory of these spousal cases (assuming *arguendo* that they are correctly decided) to either the parental relationship at issue in the case at bar or any other relationship is entirely unjustified.

[9] *Blau v. Lehman*, 368 U.S. 403, 409 (1962).

[10] If an insider passes inside information to a tippee, he may be liable under § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)); he is not liable, however, under § 16(b) because the tippee's profit is not his. *See Blau v. Lehman*, 368 U.S. 403, 411-12 (1962) ("[T]his very broadening of the categories of persons on whom these liabilities are imposed by the language of § 16(b) was considered and rejected by Congress when it passed the Act.").

The reason that Mr. Whittaker is not liable under § 16(b) is that he did not *own* his mother's securities any more than he owned her house or any of her other assets.[11] When one family member manages securities transactions as a trustee for another family member, § 16(b) simply does not apply. *See Marquette Cement Manufacturing Co. v. Andreas*, 239 F. Supp. 962, 966-67 (S.D.N.Y. 1965) (trustee of family trusts has no § 16(b) "profit realized" except to the extent that he also is the named beneficiary of one of the trusts).

The rule in § 16(b) cases should be consistent with that in analogous federal tax cases: Where a trustee or agent, even if he (like Mr. Whittaker) is related to the person he represents, receives income in his representative capacity for a beneficiary or principal, it is only that beneficiary or principal who realizes profit. *See, e.g., Ross v. United States*, 122 F. Supp. 642 (D. Mass. 1954) (father acting under power of attorney from his son realizes no profit from transactions carried on in his own name but for benefit of his son); *Heminway v. Commissioner*, 44 T.C. No. 96 (Apr. 23, 1965) (brother not taxable on profit received by him either as agent or trustee for his sister); *Nichols v. Commissioner*, 14 B.T.A. 1347, 1350 (1929) ("petitioner realized no taxable income on the sale by him as trustee for his brother"). Applying these rules, Mrs. Whittaker duly reported and paid tax on all of her profits. Mr. Whittaker certainly had no obligation to report his mother's transactions on his tax returns because he realized no profit therefrom.

Here, the facts found by the district court and contested by neither party on appeal were that with a general power of attorney, Mr. Whittaker effected discretionary securities transactions for his mother [App. at B-4]; that all purchases were

[11] We do not say that ownership "of record" is determinative. If an insider buys with his own money and sells for his own account, it does not matter that his securities are registered in street name or the name of someone other than himself. This sort of "equitable" as opposed to "legal" or "record" ownership, however, must be clearly distinguished from the entirely different notion of "beneficial" ownership on which the court below relied.

made with her money and all sales proceeds were deposited into her bank account [App. at B-4];[12] that Mrs. Whittaker was aged and somewhat infirm [App. at B-11]; that Mr. Whittaker and his mother maintained separate households and paid none of each other's expenses (except that occasionally Mr. Whittaker made short-term loans to his mother because her investment income was periodic) [App. at B-4]; that before the relevant trading period, Mrs. Whittaker sold her interest in a predecessor of the Corporation to her son in return for his promissory notes [App. at B-5]; that at the time of trial, Mr. Whittaker had not paid principal or substantial interest on these promissory notes and owed his mother $767,000 [App. at B-5]; that certain of Mrs. Whittaker's purchases of securities were financed with bank loans, on which she paid interest from her own funds, that might have been unnecessary if her son had repaid his promissory notes [App. at B-11]; that Mr. Whittaker might have had to forego certain of his own investments had he repaid his promissory notes [App. at B-11]; and that Mr. Whittaker was his mother's heir and the sole beneficiary under her 1963 will [App. at B-4].[13]

If the decision below is not reversed, § 16(b)'s supposedly bright lines of liability will have been so blurred by interpretation that insiders now will have to guess where they stand. The only sure results are that § 16(b) litigation will increase as the now-ambiguous boundaries of liability are explored, that counsel will use the discovery process to pry into private relationships among insiders and persons who profit from transactions in securities issued by the insiders' corporations

---

[12] For ease of administration by Mr. Whittaker's secretary, this account was joint although all deposits were of Mrs. Whittaker's funds and all withdrawals were for her personal expenses. On this score the court of appeals appears to have misinterpreted the district court's findings [App. at A-12].

[13] Mrs. Whittaker died seven years after the close of the relevant trading period, while this case was pending on appeal. Whatever profits she realized on her transactions during the relevant trading period belonged to her; and since she was never a statutory insider, her profits do not inure to the Corporation under § 16(b).

and that district courts presented with such new litigation will have to begin trying numerous, complex issues of fact. These results clearly contravene the mechanical, objective administration of the statute that Congress planned. *See Lewis v. Varnes*, 505 F.2d 785, 789 (2d Cir. 1974) ("For courts to use a flexible approach to cases arising under [§ 16(b)] and, in effect, to bring within the scope of the statute, persons whose actions do not fit squarely and literally within its terms, would actually contravene the congressional purpose and imply ambiguities in the statute which do not exist."). *See also Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 252 (1976) ("When Congress has so recognized the need to limit carefully the 'arbitrary and sweeping coverage' of § 16(b), . . . courts should not be quick to determine that, despite an acknowledged ambiguity, Congress intended the section to cover a particular transaction."); *Portnoy v. Kawecki Berylco Industries, Inc.*, 607 F.2d 765, 768 (7th Cir. 1979) (disapproving expansion of § 16(b) by "judicial legislation"); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1062 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975) (disapproving flexible approach to § 16(b) construction problems).

B. The Court of Appeals' Ruling that § 16(b)'s Two-Year Statute of Limitations Was Tolled Conflicts Directly with the Holding in *Carr-Consolidated Biscuit Co. v. Moore*, with the Legislative Scheme Enacted by Congress in 1934 and with Principles of Interpretation Set Forth in this Court's Recent Opinions Construing the Federal Securities Laws

The court of appeals reversed the district court's ruling that part of the Corporation's claim was barred by the portion of § 16(b) that provides that "no such suit shall be brought more than two years after such profit was realized." It ruled that even though the district court had specifically found that the Corporation at all times was on notice of the facts underlying its claim, Mr. Whittaker's good-faith failure to list his mother's

securities on the forms that he periodically filed with the SEC listing his own securities automatically and perpetually tolled § 16(b)'s statute of limitations.[14] The court of appeals thus has read out of the statute a restriction on liability enacted by Congress.

The tolling doctrine applied below is alien to federal procedure in general and to the federal securities laws in particular. Insiders engage in many activities that their corporations or their corporations' shareholders might assert give rise to liability. Statutes of limitations run on these claims just as they do on other claims. *See, e.g., Curtis v. Connly*, 257 U.S. 260, 264 (1921); *Korn v. Merrill*, 403 F. Supp. 377, 384 (S.D.N.Y. 1975), *aff'd*, 538 F.2d 310 (2d Cir. 1976). No tolling doctrine of which we are aware can survive a trial court finding of fact that the aggrieved party had knowledge (or even mere notice) at all relevant times of his claim. Yet, the court below applied such a rule in the context of a strict-liability claim as to which such application is the least appropriate.[15]

Under the court of appeals' ruling, insiders such as Mr. Whittaker who in good faith fail to meet the broad and technical reporting requirements promulgated by the SEC face § 16(b) liability unbridled by considerations of fault or untimeliness of claims. One need not look beyond the SEC's releases interpreting § 16(a) to ascertain that the limits of the obligation to report never can be entirely clear to insiders or

---

[14] Had Mr. Whittaker included his mother's securities on his forms, as he did after 1970, he would have noted his disclaimer of beneficial ownership therein, as the SEC's reporting regulations specifically authorize. It is unreasonable to suppose that any shareholder knowing far less than was "common knowledge" among the Corporation's officers and employees would have brought suit to test the novel parental "attribution" theory relied on below.

[15] Whatever merit the court of appeals' unrestrained approach to statutory construction may have in certain types of cases (perhaps including securities fraud cases), that approach should not be used to analyze the outer limits of the sort of strict liability that § 16(b) creates. *See, e.g., Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 422-25 (1972).

their advisors. Without a doubt, many insiders have filed and will file incomplete (but innocently incomplete) reports.[16] "When in doubt, report" may be a fair rule of thumb for the SEC to use in resolving uncertainty under § 16(a); but it will not support the court of appeals' harsh corollary that even an innocent failure to report automatically and indefinitely extends the period within which an insider must stand ready to defend a claim under § 16(b). Congress certainly did not expressly provide for such an unusual tolling rule in § 16(b), and there is no suggestion in the legislative history that Congress intended it.[17]

The court of appeals rejected the reasoning and holding of *Carr-Consolidated Biscuit Co. v. Moore*, 125 F. Supp. 423, 431-32 (M.D. Pa. 1954), in which the court held that the language of § 16(b), when compared with other limitations provisions enacted at the same time, indicates that Congress refused to allow for tolling. The court of appeals acknowledged the obvious soundness of this "comparison-of-related-provisions" technique[18] but rejected it here because, it said, the related limitations provisions of the 1934 Act (§§ 9(e) and 18(c), 15 U.S.C. §§ 78i(e) and 78r(c)) are themselves ambiguous. Whatever ambiquity may be found in particular provisions, however, Congress' overall intent in 1934 to restrict the time within which suits must be brought is very clear. As this Court

---

[16] The doubtful proposition espoused by the court of appeals that tolling is essential to discourage unscrupulous insiders from withholding reports is no justification for invoking tolling to punish responsible insiders such as Mr. Whittaker whose failures to file complete reports are innocent. Whatever deterrence or punishment is needed to deal with the unscrupulous exception is amply supplied by the powerful criminal sanctions of § 32(a) of the 1934 Act (15 U.S.C. § 78ff(a)).

[17] The meager evidence of congressional intent relied on by the court of appeals is the supposedly-overarching, anti-insider animus underlying § 16(b) and the "complementary" placement of §§ 16(a) and 16(b) within the 1934 Act.

[18] *See, e.g., SEC v. Sloan*, 436 U.S. 103, 112-14 (1978) (various notice-and-hearing provisions must be read together); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206-09 (1976) (various standard-of-liability provisions must be read together); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733-36 (1975) (various standing-to-sue provisions must be read together).

noted in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 208-10 (1976), Congress in 1934 amended § 13 of the Securities Act of 1933 (15 U.S.C. § 77m) to tighten such time restrictions. Significantly, where Congress had created new liability *without fault* under § 12(1) of the 1933 Act (15 U.S.C. § 77*l* (1) (selling unregistered securities), it conditioned that new sort of liability by a one-year time bar in § 13 that cannot be tolled (for example, by virtue of an inadvertent failure to file a registration statement under § 5 of the 1933 Act (15 U.S.C. § 77e)). Thus, it is fair to conclude that Congress did not mean by its "silence" to provide for tolling of § 16(b)'s two-year statute in the event of an inadvertent failure to comply with the reporting regulations to be promulgated by the SEC pursuant to § 16(a). Congress said what it meant: "no such suit shall be filed more than two years after such profit was realized." Its decision in this regard is conclusive. *See Holmberg v. Armbrecht*, 327 U.S. 392, 395 (1946); *Department of Water & Power v. Allis-Chalmers Manufacturing Co.*, 213 F. Supp. 341, 348 (S.D. Cal. 1963).

C. Calculating Liability for "Profit Realized" by Mechanically Applying a Fictional "Lowest In Highest Out" Formula, Regardless of the Circumstances, Penalizes Mr. Whittaker and Other Insiders who Innocently Fall Victim to § 16(b)'s Trap for the Unwary

This Court has withheld decision on the validity of "lowest in highest out" as a formula for determining § 16(b) "profit". *See Blau v. Lehman*, 368 U.S. 403, 407 n.4 (1962). The Seventh Circuit Court of Appeals has stated that it will not apply the formula. *See Allis-Chalmers Manufacturing Co. v. Gulf & Western Industries, Inc.*, 527 F.2d 335, 356 (7th Cir. 1975) (dictum), *cert. denied*, 424 U.S. 928 (1976), *aff'g in part, rev'g in part on other grounds* 327 F. Supp. 570, 580 (N.D. Ill. 1974) ("The concept of maximizing profit by using such theories as 'lowest in and highest out' as espoused in the 1943 decision of the 2nd circuit in *Smolowe v. Delendo Corporation*,

136 F.2d 231, 239, is not the law in this (7th) Circuit.").[19] The court below has now joined the Second and Eighth Circuits, which have approved "lowest in highest out" as the proper mechanic for "squeezing all the profit" out of § 16(b) transactions.[20]

The commentators have attacked the formula on the grounds that it is contrary to the language, legislative history[21] and logical underpinnings of § 16(b) and that it is wickedly arbitrary and penal. *See* J. Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn in Order to Kill the Rats"*, 52 Cornell L.Q. 69 (1966); W. Painter, *The Evolving Role of Section 16(b)*, 62 Mich. L. Rev. 649 (1964); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592 (1974); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. Rev. 1289 (1973).

A simple hypothetical will illustrate the problem facing insiders who inadvertently run afoul of § 16(b). Suppose that on Day 1 an insider purchases one share of his company's stock at $1 and on Day 2 sells one share at $2. Then suppose that over the next five months the market price of the stock rises steadily and that on Day 160 the insider purchases one share at

---

[19] The court of appeals' ruling was dictum because the profit-calculation issue in *Allis-Chalmers* involved valuation of securities rather than trade-matching. In prior dictum in a case discussing the tax consequences of an insider's payment in satisfaction of § 16(b) liability, *Anderson v. Commissioner*, 480 F.2d 1304, 1307 (7th Cir. 1973), another panel of the court referred to "lowest in highest out" with seeming approval.

[20] As indicated below, "lowest in highest out" in fact does not always yield the greatest "profit".

[21] There is absolutely no support in the legislative history for the notion that Congress intended to force insiders to disgorge more than their *actual* profit. *See Hearings on S. 84, 56 and 97 Before the Senate Committee on Banking and Currency*, 73 Cong., 2d Sess. 6557-59 (1934), *discussed in* W. Painter, *The Evolving Role of Section 16(b)*, 62 Mich. L. Rev. 649, 653 (1964). Indeed, Congress considered but rejected early versions of § 16(b) that expressly provided for the "lowest in highest out" formula. *See* § 15(b) of S. 2642 and H.R. 7852, 73d Cong., 2d Sess. (1934).

$100 and on Day 161 sells one share at $101. Blind application of "lowest in highest out" would lead a court to match the "lowest in" purchase on Day 1 ($1) against the "highest out" sale within six months on Day 161 ($101) and hold the insider liable to the issuer for a "profit realized" of $100. We submit that such an absurd and unjust result can be reached only by capriciously disregarding the language and legislative history of § 16(b) and by frankly abandoning any lingering notion that the statute should be administered fairly. Plainly, the "profit" in the hypothetical, under any reasonable construction and legitimate use of that word, is $1 on the first pair of transactions and $1 on the second pair of transactions; and any profit-calculation method that derives a different result is invalid.

There are alternatives. The alternative most consistent with the intent of Congress as reflected in the legislative history is to afford insiders—and especially those insiders who prove that their violations were inadvertent—an opportunity to prove what their *actual profits* really were. *See* Munter, *Section 16(b) of the Securities Exchange Act of 1934: An Alternative to "Burning Down the Barn to Kill the Rats"*, 52 Cornell L.Q. 69, 83-85 (1966); W. Painter, *The Evolving Role of Section 16(b)*, 62 Mich. L. Rev. 649, 655 & n.19 (1964) ("As Senator Barkley commented in the hearings already referred to, 'It seems to me the simple way would be to charge him [the insider] with the actual profit.' This may appear to be a naive over-simplification, but it seems to be precisely what Congress attempted to do.").

A less-flexible alternative, the "time-matching" rule that we proposed below, is identical to "lowest in highest out" except that a sale may not be matched against a purchase if there is an intervening, unmatched sale. Mechanically, the proposed procedure is as follows: Against the purchase at the lowest price, match the sale at the higher price of the two sales most immediately preceding and following. If the matched sale involved fewer shares than the matched purchase, match against the unmatched part of the purchase, the sale at the higher price of the two unmatched sales most immediately preceding and following. Repeat the process until all of the

shares purchased at the lowest price have been matched against previously-unmatched sales contiguous in time. Repeat the process for all other purchases, taking them in order of their prices from lowest to highest.[22]

The proposed formula attempts to reflect the limited purpose of § 16(b), that is, the idea that § 16(b) is intended to remedy only "short-swing" or "double-transaction" abuses of non-public information in which the insider does not intend to change his securities holdings permanently.[23] *See Provident Securities Co. v. Foremost-McKesson, Inc.*, 506 F.2d 601, 609 (9th Cir. 1974), *aff'd*, 423 U.S. 232 (1976); *Hearings on H.R. 4344, 5065 and 5832 Before the House Committee on Interstate and Foreign Commerce*, 77 Cong., 1st Sess. 1255 (1942) (SEC Commissioner Purcell commending Congress for limiting § 16(b) to short-swing abuses of inside information); Note, *Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach*, 72 Mich. L. Rev. 592, 598-99, 602-08 & nn. 41-61 (1974); Comment, *Section 16(b): An Alternative Approach to the Six-Month Limitation Period*, 20 U.C.L.A. L. Rev. 1289, 1294-95 (1973). The "lowest in highest out" formula, on the other hand, encourages matchings of purchases and sales furthest apart in time, *i.e.*, those *least* likely to be related parts of the sort of single-transaction abuse that Congress intended § 16(b) to remedy.

---

[22] In some circumstances, the time-matching rule "squeezes" more profit from insiders than does "lowest in highest out":

Dates	One-Share Purchases	One-Share Sales
1/1	$10	
1/20		$100
1/30		$ 11
7/10	$ 9	
7/15		$ 99

Under "lowest in highest out" the "profit" is $92 (7/10 v. 1/20 for $91; 1/1 v. 1/30 for $1); under the alternative rule the "profit" is $180 (7/10 v. 7/15 for $90; 1/1 v. 1/20 for $90). Perhaps a computer could test all of the possible matchings to "squeeze" the most "profit", but that surely is not what Congress intended in 1934.

[23] Other statutory and regulatory provisions (*e.g.*, § 10(b) of the 1934 Act (15 U.S.C. § 78j(b)) and Rule 10b-5 (17 C.F.R. § 240.10b-5)) are avilable to remedy "single-transaction" abuses. *See Foremost-McKesson, Inc. v. Provident Secs. Co.*, 423 U.S. 232, 255 (1976).

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit Court of Appeals.

Respectfully submitted,

WILLIAM THOMPSON BISSET
515 South Flower Street
Los Angeles, California 90071

May 8, 1981.

APPENDIX A

United States Court of Appeals

FOR THE NINTH CIRCUIT

WILLIAM R. WHITTAKER, *Plaintiff/Appellant,* v. WHITTAKER CORPORATION, *Defendant/Appellee.*	DOCKET NOS. 77-2297 77-2550

Appeal from the United States District Court for the Central District of California.

Before CHAMBERS and TANG, Circuit Judges, and ORRICK,* District Judge.

TANG, Circuit Judge:

This case involves liability under the insider short-swing trading provisions of the Securities Exchange Act of 1934, § 16, 15 U.S.C. § 78p. The principal questions presented are whether shares nominally owned by another may be attributed to an insider for liability under § 16(b) and whether the two-year limitations period of § 16(b) may be tolled. On demand by the Whittaker Corporation (Corporation), the putative insider, William Whittaker (William), paid the amount of alleged profits from insider transactions between December 1, 1965 and December 31, 1970 (the relevant trading period). He later sought a declaratory judgment of nonliability under § 16(b) and return of the monies previously paid. The district court found William liable but also found that the statute of limtiations of § 16(b) operated to cut off liability for transactions prior to January 29, 1969. We affirm the district court on the issue of William's liability, but we reverse and remand on the limitations issue.

* Honorable William H. Orrick, Jr., United States District Judge for the District of Northern California, sitting by designation.

PRELIMINARY BACKGROUND

The Whittaker Corporation is a corporation in which William Whittaker and his mother, Beulah Whittaker, owned substantial percentages of stock. William was a director and Chairman of the Board of Directors during the relevant trading period. In 1965, because of amendments broadening § 16, the Corporation became subject to § 16 of the Securities Exchange Act of 1934, 15 U.S.C. § 78p (hereinafter § 16).

Briefly, § 16(a) requires "insiders"—any person who is a 10% beneficial owner of a company whose securities are registered under the Act or a director or an officer of the company—to file monthly reports with the Securities and Exchange Commission (SEC) showing any changes in the person's ownership in the company. Section 16(b) declares that any profits which such person may realize by any purchase and sale of the company's securities within six months shall inure to and be recoverable by the company. Suits to recover such profits may be brought by the company or by any shareholder in a derivative suit if the company fails to do so. No such suit shall be brought more than two years after the date such profit was realized.

Since 1959 William had power of attorney from his mother Beulah to conduct business matters for her. The securities transactions involved in this case took place between December 1, 1965 and December 31, 1970. William purchased Whittaker Corporation common stock and convertible debentures for his mother's account, and within six months of such purchases, sold common stock for his own account and convertible debentures and common stock for his mother's account. None of the transactions involving securities for his mother's account were reported to the SEC as required by § 16(a). The district court determined that, because of the relationship between William and his mother, the control William had over her stock, and the benefits he realized from it, he must be deemed the beneficial owner of his mother's stock, and so should have reported the

transactions under § 16(a) and was liable to the corporation under § 16(b) for profits derived from those transactions involving his mother's stock which he realized by a purchase and sale of the Corporation's securities within six months.

The Corporation asserts it did not learn of the full extent of William's total control over his mother's shares until the fall of 1970. It then compiled a list of all William's transactions in the securities of the Corporation, determined which were six-month short-swing insider trades, and computed the profit realized by William. In January 1971, the Corporation demanded payment of these realized profits plus interest.

On January 29, 1971, William paid the amount demanded, denied liability and reserved the right to bring an action to determine his liability and to seek return of the monies. William remained with the Corporation as President until November 1974 and as Chairman of the Board until January 31, 1975. On July 29, 1975, William and his mother commenced this action for a declaration of nonliability under § 16 and recovery of the money.

Trial was held before the court without a jury. The district court found that William was liable as an insider for the transactions in his mother's shares, but that the statute of limitations of § 16(b) barred recovery for all but one year of the relevant trading period. That is, only profits on transactions within two years prior to the Corporation's demand in January 1971 could be recovered. On the transactions for which the Corporation could recover, the district ourt computed profits realized according to the rule of "lowest price in, highest price out" within six months and awarded the Corporation prejudgment interest. The Corporation was then ordered to pay back the balance of the money paid in 1971.

ISSUES ON APPEAL

1. Was the Corporation's notice of appeal filed timely? (Raised by William on motion to dismiss)

2. Was William the beneficial owner of his mother's shares, so that profits realized in his transactions in those shares were "profits realized by him" for § 16(b) liability? (Raised by William on cross-appeal)

3. How should the two-year limitations period of § 16(b) be construed? (Raised by the Corporation on appeal)

4. Is the "highest sales price, lowest purchase price" method for computing profits in insider trading the correct method? (Raised by William on cross-appeal)

5. Was the award of prejudgment interest on the amount of profits recovered by the Corporation incorrectly decided by the district court? (Raised by William on cross-appeal)

I.

NOTICE OF APPEAL

William has moved to dismiss the Corporation's appeal on the ground that the notice of appeal was not timely filed. The judgment of the district court was entered on April 7, 1977. The judgment included the award of costs to the plaintiffs, William and Beulah Whittaker, as the prevailing party. On April 14, 1977 defendant Corporation moved to retax costs, specifically that all parties "bear their own taxable costs pending appeal of this action." The Corporation argued that it, not the plaintiffs, should be considered the prevailing party. The motion to retax costs was denied on April 20, 1977. Having learned that William would oppose any filing of a notice of appeal as untimely on the ground that the 30-day period for filing under Fed.R.App.P. 4(a) had begun on April 7, 1977 and so had expired, the Corporation moved the district

court for either 1) a determination that the motion to retax costs had extended the time for filing a notice of appeal since it was a Fed.R.Civ.P. 59(e) motion to alter or amend the judgment or 2) an extension of time for filing the notice of appeal by reason of "excusable neglect" in learning of the date of entry of judgment. The district judge rejected the excusable neglect contention but agreed the motion was a Rule 59(e) motion, even though it was denied. He ordered the Corporation's notice of appeal accepted for filing. It was filed May 18, 1977.

Failure to file a timely notice of appeal is jurisdictional; and the Court of Appeals would lack jurisdiction to review the judgment. *Browder v. Director, Department of Corrections,* 434 U.S. 257, 264, 98 S.Ct. 556, 561, 54 L.Ed.2d 521 (1978); *Rodriguez v. Southern Pacific Transportation Co.,* 587 F.2d 980, 981 (9th Cir. 1978); *Alexander v. Sacha,* 439 F.2d 742 (9th Cir. 1971). The notice of appeal must be filed within 30 days of the entry of judgment. Fed.R.App.P. 4(a). But the running of this time is terminated by a timely filed motion under, *inter alia,* Fed.R. Civ.P. 59(e) (motion to alter or amend the judgment), and the 30-day time commences anew from the date such motion is decided. The Corporation's motion was filed within the 10-day time limit for Rule 59(e) motions. Its notice of appeal was filed more than 30 days from the entry of judgment, but less than 30 days from the district court's denial of its motion to retax costs. The issue then is whether the Corporation's motion is a 59(e) motion (which extends the time for appeal) or a Rule 54(d) motion which reviews the Clerk's actions regarding costs (which does not extend the time for appeal.)

The Corporation styled its motion a motion to retax costs and did not recite that it was proceeding under Rule 59(e). "But nomenclature is not controlling." What is required is that the requested relief be "relief which might have been granted under Fed.R.Civ.P. 59(e)." *Sea Ranch Ass'n v. California Coastal Zone Conservation Comm'n,* 537 F.2d 1058, 1061 (9th

Cir. 1976). *Accord Mir v. Fosburg*, No. 78-1103, Slip Op., at 1707, ... F.2d ....., at .... (9th Cir. Jan. 22, 1980).

A motion to amend the judgment with respect to costs has been heard as a 59(e) motion where the motion was to tax costs against a different party, *United States v. Crawford*, 36 F.R.D. 174 (W.D.La. 1964); or to delete the award of costs altogether, *United States v. 2,186.63 Acres of Land*, 464 F.2d 676, 677 (10th Cir. 1972); or to add costs where none were in the judgment before, *see Alameda v. Paraffine Companies, Inc.*, 169 F.2d 408, 409 (9th Cir. 1948) (prior to Rule 59(e), treating such motion as amending judgment so as to extend time for filing notice of appeal).[1]

On the other hand, Rule 54(d) motions are appropriate for correcting clerical errors in the bill of costs, disputing particular items or amounts, or otherwise amending an accepted award of costs. For substantive challenges as to the appropriateness of awarding costs at all, especially where such challenge involves a redetermination of who was the prevailing party, Rule 59(e) may be appropriate. We do not mean to imply that these categories are exclusive. It may be that some motions could be characterized as under both Rules 54(d) and 59(e) motion [*sic*].

William relies on *Environmental Defense Fund, Inc. v. Froehlke*, 368 F.Supp. 231 (W.D.Mo. 1973), *aff'd*, 497 F.2d 1340 (8th Cir. 1974). But in *Froehlke* the district judge found

[1] Similarly, motions to reconsider the award of attorney's fees and motions to add attorney's fees to the judgment have been treated as Rule 59(e) motions. *See Hammond v. Public Finance Corp.*, 568 F.2d 1362 (5th Cir. 1978); *Stacy v. Williams*, 50 F.R.D. 52 (N.D.Miss. 1970), *aff'd*, 446 F.2d 1366 (5th Cir. 1971); *Farmington Dowel Products Co. v. Forster Mfg. Co.*, 421 F.2d 61, 76 n. 39 (1st Cir. 1969). *Contra Lichtenstein v. Lichtenstein*, 55 F.R.D. 535, 537 (E.D.Pa. 1972), *rev'd on other grounds*, 481 F.2d 682 (3d Cir. 1973), *cert. denied*, 414 U.S. 1144, 84 S.Ct. 895, 39 L.Ed.2d 98 (1974) (motion to amend judgment to add attorney's fees treated as 54(d) motion, not 59(e) motion, but done so in order to avoid dismissal of motion as untimely).

that the plaintiffs actually were seeking only a review of amount of costs and a determination of which costs were taxable to plaintiffs. 368 F.Supp. at 252-53. Moreover, the court appears to have been led to treat the motion as a 54(d) motion so as to reach the merits and avoid the untimeliness problem created if it were treated as a 59(e).[2]

The Corporation's motion here was not a motion challenging any item of cost or amount of any item as assessed by the Clerk. Rather, it was a challenge as to who should be entitled to costs, that is, a question of who the prevailing party was. As the district judge recognized, because of the unusual procedural circumstances of this case, the roles of plaintiff and defendant were, in effect, reversed. Normally, the corporation would be the plaintiff, suing to recover the insider profit. Although William was technically the prevailing party since he won a money judgment, the Corporation had prevailed on the gravamen of its claim. If the suit had been a normal insider trading case, the Corporation would have "prevailed." Thus, the Corporation's motion went to the heart of how the judgment was to be characterized. The district judge is surely in a position to understand the ramifications of the motion on the judgment. *Cf. In re Estate of Butler's Tire & Battery Co., Inc.*, 592 F.2d 1028, 1032 (9th Cir. 1979) (district court's extension of time for appeal for excusable neglect under Fed.R.App.P.

---

[2] *See* 368 F. Supp. at 253. William also relies extensively on *Knowles v. United States*, 260 F.2d 852 (5th Cir. 1958). But *Knowles* does not aid William. In *Knowles*, the plaintiff was disputing only two items of cost. Moreover, those costs had been levied on plaintiff by the district court in regard to a prior appeal of the case; they were not directly related to the judgment appealed from. Those costs were treated as a separate matter by both the district court and the Fifth Circuit. Finally, from the Fifth Circuit's opinion it is apparent neither that the motion to vacate these costs was made or treated as a rule 59(e) motion nor that it was even timely filed as a Rule 59(e) motion with respect to the judgment Knowles sought to appeal. If it were not a *timely* Rule 59(e) motion, it could not have extended the time for appeal.

4(a) overturned only for abuse of discretion). He thought the relief requested, if granted, "would have necessarily resulted in an amendment for that judgment."[3]

We agree and consider the Corporation's motion correctly construed as a Rule 59(e) motion. Since it was timely filed, it extended the time for filing the notice of appeal under Fed.R.App.P. 4(a). The Corporation's appeal is timely.

II.

BENEFICIAL OWNERSHIP AND PROFIT REALIZED

A. General Principles for § 16

Section 16(b) declares, in effect, that directors, officers, and 10% beneficial owners are presumed to have inside information and then states the corporation can recover any profits made by these insiders on transactions within a six-month period. This recovery rule is virtually automatic. Neither actual possession of inside information nor use of such information need be shown. Even initial good faith intent to hold the securities for longer than six months is no defense. "In short, this statute imposes liability without fault within its narrowly drawn limits." *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 at 251, 96 S.Ct. 508 at 519, 46 L.Ed.2d 464. However, "it is an objective rule and does not reach every transaction in which an investor actually relies on inside information, or in which the potential for such reliance is

[3] The problem was only partly that the judgment as signed had expressly contained an award of costs to William. Even if that were not in the judgment, and the Clerk had merely awarded costs to William as a matter of course as the "prevailing party," a motion challenging the Clerk's action on the ground that the Corporation should be deemed the true prevailing party would still be a Rule 59(e) motion insofar as it sought an interpretive amending of the judgment.

great." *Lewis v. Varnes*, 505 F.2d 785, 787 (2d Cir. 1974). *See Blau v. Max Factor & Co.*, 342 F.2d 304, 307 (9th Cir.), *cert. denied*, 382 U.S. 892, 86 S.Ct. 180, 15 L.Ed.2d 150 (1965); *Rheem Mfg. Co. v. Rheem*, 295 F.2d 473, 475 (9th Cir. 1961). *See generally* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1040-44.

In interpreting § 16 for situations which do not fall obviously within its scope, a certain tension is immanent. On the one hand, "where alternative constructions of the terms § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders." *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 at 424, 92 S.Ct. 596 at 600, 30 L.Ed.2d 575. This "objective approach" goes back to the earliest cases interpreting the statute. "The statute is broadly remedial. . . . [I]t was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of [an insider] and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 239 (2d Cir.), *cert. denied*, 320 U.S. 751, 64 S.Ct. 46, 88 L.Ed. 446 (1943). *See also Adler v. Klawans*, 267 F.2d 840, 846 (2d Cir. 1959) (§ 16 to be interpreted broadly so as to give full effect to plain congressional intent).

On the other hand, because of the mechanical application of § 16(b), imposing liability without fault on transactions within its scope, courts more recently have been hesitant to bring borderline transactions under that scope by interpretation where congressional intent was unclear and the transaction in question was not of a type giving rise to speculative abuse. *See, e.g., Foremost-McKesson, Inc.*, 423 U.S. at 252, 96 S.Ct. at 520 (person must be 10% owner prior to purchase at issue); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 at 593-95, 93 S.Ct. 1736 at 1744-1745, 36 L.Ed. 2d 503 (sales in context of blocked tender offer); *Reliance Electric Co.*, 404 U.S. at 424 n.4, 92 S.Ct. at 600 n.4 (person must be 10% owner at

time of sale at issue); *Blau v. Max Factor & Co.*, 342 F.2d at 306-09; *Lewis v. Varnes*, 505 F.2d at 789; *Matas v. Siess*, 467 F.Supp. 217, 220-21, 224 (S.D.N.Y. 1979).

Under this "subjective" or pragmatic" approach, courts inquire whether the transaction involved carries a potential for insider abuse. Only those types of transactions which do are then found included within the statutory scope. *Kern County Land Co.*, 411 U.S. at 594-95, 93 S.Ct. at 1744-1745. However, the pragmatic approach has not ousted the objective view. Rather, the pragmatic approach is used to determine the boundaries of the statute's definitional scope in borderline situations, especially unorthodox transactions. *Id.* For a garden-variety transaction which cannot be regarded as unorthodox, the pragmatic approach is not applicable. *Moulding, Inc. v. Potter*, 465 F.2d 1101, 1104-05 (5th Cir. 1972), *cert. denied*, 410 U.S. 929, 93 S.Ct. 1368, 35 L.Ed.2d 591 (1973); *Tyco Laboratories, Inc. v. Cutler-Hammer, Inc.*, 490 F.Supp. 1, 7 (S.D.N.Y. 1980); *Matas v. Siess*, 467 F.Supp. at 220. In such cases, if the situation is within the requirements established by Congress for § 16, then the mechanical, "objective," operation of the statute imposes liability.

B. The Question Presented and Factual Background

Under § 16(b), the corporation may recover "any profit realized by him [the insider]" in covered short-swing transactions. In the present case, the securities in question were in William's mother's name and the profits realized in their trading went into her accounts. Thus, the question arises whether these profits[4] were profits "realized *by him*" and so recoverable or were realized only by his mother and so not

[4] More accurately, if the Corporation's position is correct and these securities are treated as William's, then profits would be computed by comparing purchases and sale of all the securities (both in Beulah's and William's names) and not merely comparing purchases and sales of those securities in the mother's name.

covered by § 16(b). William, relying on the narrow interpretive approach discussed above, argues that the term "by him" should be read strictly and narrowly and that, so read, it does not include the profits herein. The Corporation and the district court below, however, use the concept of "beneficial ownership" in § 16(a) in order to give content to the term "realized by him" in § 16(b). Under that analysis William was found liable under § 16(b).

William raises his issues on cross-appeal as pure questions of law; he disputes none of the fact findings below. Accordingly, we accept and rely on the facts as found by the district court. In any event, the district court's findings of fact as to these issues are not clearly erroneous under Fed.R.Civ.P. 52(a). Pertaining to the ownership issue, the district court found the following.[5] In 1959, because of her advancing age, his mother granted William a broad general power of attorney, giving him the right to pay her bills, sign checks for her, manage her financial and business affairs, and purchase and sell securities for her investments. In 1969, this power was renewed. "At all times relevant to this litigation, Mr. Whittaker made and executed virtually all investment and business decisions for his mother on his own initiative and in his sole discretion pursuant to this power of attorney."

A joint bank checking account, bearing Beulah's and William's names, was set up for her expenses. From 1960 and throughout the relevant trading period, William maintained and personally signed all checks drawn on this joint account. During the same period, Beulah's income was deposited to this account and her expenses paid from it.

The district judge further found that "it is clear that Mr. Whittaker exercised virtually complete control over his mother's affairs . . . ." Throughout the relevant trading period,

[5] This account is taken principally from pages 4-6 and 12-13 of the district court's unpublished opinion, *reprinted in* [1977-1978 Transfer Binder] CCH Fed.Sec.L.Rep. ¶ 96,008 at 91,528-29 & 91,531.

William received a series of substantial loans from his mother. His control over her finances enabled William "to freely borrow large sums of money from her while never having to consider paying the money back, posting adequate security or even paying any interest that might accrue." Moreover, William used his mother's assets to fund, through interest-free loans, advantageous investment opportunities he otherwise might have had to forego. William would borrow from a bank in his mother's name, and the interest would be paid from her funds.

As the district judge summarized, "[i]n short, the evidence indicates that Mr. Whittaker felt free to utilize his mother's assets exactly as if they were his own. It is thus obvious that Mr. Whittaker stood to gain on any profits he might make for his mother through the purchase and sale of Whittaker Corporation securities.[6]

C. "Profit realized by him"

On this factual basis, the district court concluded that William was the "beneficial owner" of the securities under the definition of beneficial owner developed for § 16(a). Insiders must include in their reports required under § 16(a) those securities of which they are the "beneficial owner." *See* SEC Securities Exchange Act Release No. 7793 (Jan. 19, 1966) (discussed at page 526 *infra*). Under the applicable principles William was the beneficial owner and should have included them in his § 16(a) reports. This determination is uncontested. The district court then held that, if one is the beneficial owner, the securities are "his," and thus one must be chargeable with the profits under § 16(b), relying on *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975), *aff'g*, 386 F.Supp. 1130 (S.D.N.Y. 1974), and on *Altamil Corp. v. Pryor*, 405 F.Supp. 1222 (S.D. Ind. 1975).

[6] The district court also noted that this was supported further by the fact that William was the sole beneficiary under his mother's will and would be her sole intestate heir, that she was of an advanced age and in poor health, and that it was unlikely that her will would be changed.

William contends the district court was in error because *Blau v. Lehman*, 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), requires a narrow reading of "profits realized by him" in § 16(b) and particularly because the equation of "beneficial ownership" for § 16(a) reports with profit attribution for § 16(b) liability is erroneous as a matter of law. We reject William's contentions and affirm the district court on this issue. Our affirmance rests on two distinct grounds.

First, quite apart from any consideration of beneficial ownership, we hold that on the facts as found by the district court the profits are profits realized by William under § 16(b). William controlled his mother's investments. He thus controlled the trading in Corporation securities. He determined the timing and amount of sales and purchases. William had control over his mother's assets and so had control over money received for the Corporation securities. He could use those assets as freely as if they were his own. And in fact he did so use them, in large amounts, on several occasions. On these facts—control over the securities and unfettered ability to use the money for his own benefit—any reasonable interpretation of "profit realized by him" must encompass the instant case. *Cf. Mouldings, Inc. v. Potter*, 465 F.2d at 1103-05 (insider designated others to whom profits would go, profits held attributable to insider for § 16(b) liability).

Blau v. Lehman, 368 U.S. 403, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962), on which William relies principally, does not require a different result. In *Lehman*, Blau, a shareholder in Tide Water, brought a § 16(b) claim against Lehman Brothers, an investment banking house, and Thomas, a partner in Lehman Brothers and a director of Tide Water. While Thomas was a director of Tide Water, Lehman Brothers had engaged in short-swing trading of Tide Water stock for its own account and realized profits thereon. The Supreme Court held that all the Lehman Brothers profits were not profits realized by Thomas personally and so Thomas was not liable for them under § 16(b). 368 U.S. at 413-14, 82 S.Ct. at 456-457.

William argues that, just as the Lehman profits were not attributable to Thomas, so his mother's profits are not attributable to him. William's reliance is misplaced. *Lehman* is clearly distinguishable. One partner in an investment firm has neither the same control over trading nor the same benefit from profits in the firm's portfolio that William had over his mother's securities. Indeed, several of the facts in *Lehman* underscore this distinction. Lehman Brothers purchased the Tide Water securities without consulting Thomas, and, once the purchases were discovered, Thomas was insulated from financial interest in them. *See* 368 U.S. at 406, 82 S.Ct. at 453. While it may have been "nothing but a fiction to say that Thomas 'realized' all of the profits earned by the partnership of which he was a member," 368 U.S. at 414, 82 S.Ct. at 457, it would be an equal fiction here to say these profits are not William's.[7]

D. "Beneficial ownership" and "profit realized"

Our second rationale for affirmance involves consideration of the interrelationship between beneficial ownership in § 16(a) and profits realized by him in § 16(b). While we agree with the district court's result and also agree that there is a strong relationship between these provisions of § 16(a) and § 16(b), we do not agree that there is always an automatic equivalence between the two.

The intent and purpose of § 16 must be gleaned from the statute as a whole rather than from its isolated parts. *Adler v. Klawans*, 267 F.2d 840, 844 (2d Cir. 1959). Sections 16(a) and 16(b) must also be read together because they are

[7] William also cites several cases in which other provisions of § 16(b) have been construed strictly and argues that "profits realized by him" must be similarly construed. *See Foremost-McKesson, Inc., supra; Kern County Land Co., supra; Reliance Electric Co., supra. See* page 10 *supra. See also Lewis v. Mellon Bank*, 513 F.2d 921 (3d Cir. 1975); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975).

grammatically related. *See American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1058 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397, 44 L.Ed.2d 667 (1975). In particular, the scope and definition of insider or beneficial owner for § 16(b) has been determined by reference to § 16(a). *See Foremost-McKesson, Inc.*, 423 U.S. at 234 n.1, 96 S.Ct. at 511 n.1; *Kern County Land Co.*, 411 U.S. at 591 n.21, 93 S.Ct. at 1743 n.21; *Reliance Electric Co.*, 404 U.S. at 419 n.1, 92 S.Ct. at 596 n.1 (second paragraph). Under § 16(a), an insider is required to report changes in ownership of covered securities "of which he is the beneficial owner." Thus, for reporting purposes, stock ownership is attributed to directors and officers (as well as to principal—10%—shareholders) by the concept of beneficial ownership. Moreover, the identity of some insiders (*i. e.*, those who are insiders by virtue of 10% beneficial ownership) for § 16(b) liability is determined by reference to § 16(a). Thus, it is not far-fetched similarly to determine by reference to § 16(a) what stock those insiders own for § 16(b) liability.

The Second Circuit adopted this approach in a similar situation. In *Whiting v. Dow Chemical Co.*, 523 F.2d 680 (2d Cir. 1975), *aff'g* 386 F.Supp. 1130 (S.D.N.Y. 1974), the court determined that a spouse's shares were beneficially owned by the insider and that once the insider is the " 'beneficial owner,' he must be chargeable with all the profits or none." *Whiting*, 523 F.2d at 689. In *Whiting* the shares were owned by the non-insider wife, and she had predominant control over them. However, analyzing all the facts, the court determined that the transactions were part of a jointly managed common investment plan, that the income was available to both spouses, and in particular that the proceeds of the sale of the wife's shares had been used to finance the husband's purchases. The court then concluded these facts made the husband the benefi-

cial owner of these stocks under the SEC's definition of beneficial ownership. *See* SEC Securities Exchange Act Release No. 7793 (Jan. 19, 1966) ("Release 7793").[8]

Essentially, under Release 7793, a person is a beneficial owner of shares held in another's name if the person either obtains benefits substantially equivalent to ownership or has the power to revest title in himself. However, Release 7793 defined beneficial ownership only for purposes of the § 16(a) reporting requirement. A subsequent SEC Release made it clear that the requirement to report beneficially owned shares was not coextensive with § 16(b) liability. SEC Securities Exchange Act Release No. 7824 (Feb. 14, 1966), *reprinted in* CCH Fed.Sec.L.Rep. ¶ 26,030 ("Release 7824"). Rather, liability under § 16(b) for transactions in beneficially owned shares is "to be determined by the facts of each particular case in an appropriate action brought by the issuer or its security holders." Release 7824. Under Release 7793, "a person ordinarily should include in his [§ 16(a) reports] securities held in the name of a spouse or minor children as being beneficially owned by him." It is this routine, automatic ("ordinarily") quality of § 16(a) reporting that makes the mere presence of a § 16(a) reporting requirement, without more, unsuitable as a conclusive determinant of § 16(b) liability.

The *Whiting* court recognized this limitation on § 16(a) beneficial ownership, 523 F.2d at 687, and further recognized the underlying reason for it—namely, that "[a] definition of 'beneficial ownership' may be broad enough to require reporting for purposes of public exposure but too broad for the imposition of liability under § 16(b)." 523 F.2d at 685 n.8.

---

[8] SEC Release 7793 is reprinted in CCH Fed.Sec.L.Rep. ¶¶ 26,031 & 26,032. It appears in pertinent part in *Whiting*, 523 F.2d at 686 n.10. For general discussions of Release 7793, *see* 5 L. Loss, *Securities Regulation* (2d ed. Supp. 1969) at 3063-66; Feldman & Teberg, *Beneficial Ownership Under Section 16 of the Securities Exchange Act of 1934*, 17 Case Western Res.L. Rev. 1054 (1966).

But, the *Whiting* court still ended with a general proposition that, if one is the "beneficial owner," one is chargeable with the profits. 523 F.2d at 689. The *Whiting* court apparently created an unexpressed new term, "beneficial ownership for § 16(b) purposes." The court then took the defining characteristics of beneficial ownership in Release 7793 and applied them to the facts of the particular case, as Release 7824 advised. This application was done not simply to find if beneficial ownership for § 16(a) reporting was met, but to determine if the actual rewards of ownership were sufficiently present to warrant attributing the stock to the insider-spouse for § 16(b) liability. *See* 523 F.2d at 688-89. *See also* 386 F.Supp. 1130, 1136-38 (district court in *Whiting*). It was this "beneficial ownership for § 16(b)" which was dispositive in determining what profits were "realized by him."

The district court below, relying on *Whiting*, engaged in a similar reasoning. Analyzing the facts of William's control and benefit over the shares, the court concluded he "must be deemed the beneficial owner of [his mother's] securities for purposes of § 16(b)."

William argues the *Whiting* analysis equates § 16(a) reporting and § 16(b) liability and that such an equation unduly expands § 16(b). While the *Whiting* analysis is somewhat ambiguous, we do not read that case as making such an equation. Rather, the *Whiting* court engaged in a factual determination of beneficial ownership specifically for purposes of § 16(b). Nor, in following *Whiting*, did the district court in the case at bar make such an equation. The district court did not rely on the mere fact that his mother's shares were beneficially owned by William for § 16(a) reports. The court took evidence on the relation between his mother and William, the extent of William's involvement in managing her affairs, and particularly the degree of control William had over the Corporation securities, and the extent of his ability to enjoy the benefit therefrom. Only after evaluating this evidence did the

district court conclude that his mother's securities should be attributed to William in computing his profits realized under § 16(b).

In affirming the district court finding, we hold that an insider who trades in shares which he or she beneficially owns within the meaning of § 16(a) may be subject to the sanctions of § 16(b). Such liability should be imposed, however, only following a determination by the trial court not simply that the requirements of beneficial ownership were met for purposes of the § 16(a) reporting requirement, but that actual rewards of ownership were sufficiently present to warrant attributing the stock to the insider for purposes of § 16(b). In making this determination, the court should especially consider as key factors the degree to which the insider exercised control over the securities and the insider's ability to use the profits made. *See* Note, *"Beneficial Ownership" Under 16(b) of the Securities Exchange Act of 1934,* 77 Colum. L.Rev. 446, 460-62 (1977).

Williams also contends that this analysis, like the *Whiting* court's, run contrary to the strict interpretive approach of the Supreme Court in *Foremost-McKesson, Inc., Kern County Land Co.,* and *Reliance Electric Co.* Our reading of § 16(b) is not expansive. Moreover, in this instance, SEC Releases and an interrelationship between § 16(a) and § 16(b) are involved; the cited Supreme Court cases do not deal with interpretations in a similar context. Similarly, in the instance case, unorthodox transactions calling for the application of the pragmatic approach are not present. *See* discussion at pages 522-523 *supra.*

Our analysis, though approaching the issue through the theory of "beneficial ownership", arrives at the same conclusion as our analysis of whether "profits were realized" by William. *See* discussion at page 524 *supra.* Thus, the district court's finding of liability under § 16(b) must be affirmed.

III.
TWO YEAR LIMITATIONS PERIOD

A. Background

Section 16(b) provides that no suit under the section "shall be brought more than two years after the date such profit was realized." On demand by the Corporation, William paid the amount claimed on January 29, 1971. This date became the applicable date from which the statute of limitations is measured. If the two year period is applicable, then the Corporation is limited to recovery of profits realized only after January 29, 1969.

But how is the application of the two year time limit of § 16(b) to be construed? The parties present three theories of interpretation. First, William advances the "strict" interpretation under which the two years run strictly from the time the profits were realized, without any tolling. Second, there is a "notice" or "discovery" intrpretation under which the time period is tolled until the Corporation had sufficient information to put it on notice of its potential § 16(b) claim. Finally, the Corporation advances the "disclosure" interpretation under which the time period is tolled until the insider discloses the transactions at issue in his mandatory § 16(a) reports.[9]

The district judge hypothetically applied the notice interpretation. He found that various corporate officers had information which put the Corporation on notice throughout the relevant trading period. It was admitted that William did not

---

[9] There is also mention of a fraudulent concealment theory under which the time limit is tolled as long as the insider conceals the transactions from the Corporation. But as it has been used in the few prior § 16(b) cases, this is only a step in the analysis toward the disclosure interpretation. The failure to disclose in § 16(a) reports, whether intentional or inadvertent, is deemed concealment, thus triggering the traditional equitable tolling doctrine of fraudulent concealment. *See, e.g., Blau v. Albert*, 157 F.Supp. 816, 819 (S.D.N.Y. 1957) (quoting Cook & Feldman, *Insider Trading under the Securities Exchange Act (Part I)*, 66 Harv.L.Rev. 385, 413 (1953)).

disclose the transactions in his mother's shares on his § 16(a) reports as he was required to do. But the district court did not consider the disclosure interpretation separately, perhaps reasoning that actual notice would override any failure to report. Then, since tolling was not available, the district court determined it need not decide between the notice or strict interpretations.

On appeal, the Corporation renews its disclosure interpretation argument, and William renews the strict interpretation. Secondarily, accepting the notice interpretation, each side advances arguments that the facts do or do not support the district court's conclusion that the Corporation had notice. We hold the disclosure interpretation is the correct construction of § 16 and accordingly reverse the district court. Therefore, we need not reach the district court's conclusions based on the notice interpretation.

B. Tolling and the Reporting Requirement

The ultimate question is one of congressional intent, "whether tolling the limitation in a given context is consonant with the legislative scheme." *American Pipe and Construction Co. v. Utah*, 414 U.S. 538, 558, 94 S.Ct. 756, 768, 38 L.Ed.2d 713 (1974). Neither the mere fact that a statute creating a cause of action also contains a time limitation nor whether a time limitation is viewed as substantive or procedural forecloses the question of allowing or disallowing tolling; the determinative factor is whether tolling is not inconsistent with the legislative purpose. *See id.* at 556-59, 94 S.Ct. at 767-769.

The bare words of the time provision of § 16(b) do not say whether tolling is or is not allowed. Normally, we would turn to the legislative history. But the legislative history of § 16(b) is silent concerning this provision. *See Grossman v. Young*, 72 F.Supp. 375, 378 (S.D.N.Y. 1974) (first case construing time provision of § 16(b)). However, examining the legislative purpose of § 16 as a whole and considering the place of the

time provision in that overall legislative scheme, we infer that tolling of the two year time period is required when the pertinent § 16(a) reports are not filed.

The legislative history and purpose of § 16, discussed in Part II-A above, clearly reveal a strong congressional intent to curb insider trading abuses. This purpose would be thwarted if insiders could escape liability by not reporting as required under § 16(a). "[I]t would be a simple matter for the unscrupulous to avoid the salutary effect of Section 16(b) which provides a remedy for the recovery of short term profits, simply by failing to file monthly reports in violation of subdivision (a) and thereby concealing from prospective plaintiffs the information they would need to adequately protect their interests. Such a construction would reward the violation of the statute and would manifestly frustrate congressional intent." *Blau v. Albert*, 157 F.Supp. 816, 819 (S.D.N.Y. 1957). *Accord Grossman v. Young*, 72 F.Supp. at 378-79.

This conclusion is further supported by consideration of the complementary nature of § 16(a) and § 16(b). As subdivisions of the same section, they should be read together. *See, e. g., Foremost-McKesson, Inc.*, 423 U.S. at 234 n.1, 96 S.Ct. at 511 n.1; *American Standard, Inc.*, 510 F.2d at 1058. *See also* discussion at pages 525-526 *supra*. The time limit is made a part of the section itself rather than incorporated by reference to another provision. The disclosures and reports of § 16(a) are an integral part of the context of § 16 within which § 16(b) must be read. The short limitations period is understandable only in the context of the insider's duty to make prompt disclosure. *See Grossman v. Young*, 72 F.Supp. at 378. "Effective operation of Section 16(b) is made possible by Section 16(a)'s requirement of full and prompt publicity . . . ." Note, *The Scope of "Purchase and Sale" Under Section 16(b) of the Exchange Act*, 59 Yale L.J. 510, 512 (1950).

Similarly, Congress' express provision in § 16(b) that individual security holders may bring suit on behalf of the corporation to recover insider profits bolsters our interpretation.

Even if other corporate officers or directors should know of an insider's transactions, this would not be the disclosure § 16 demands, because security holders can bring suit on the corporation's behalf. "Only by full compliance with Section 16(a) can the security holders be charged with adequate notice of the transaction." Cook & Feldman, *Insider Trading Under the Securities Exchange Act (Part I)*, 66 Harv.L. Rev. 385, 414 (1953). Such shareholders are likely to be outsiders, minority holders. Their main source of information for the suits Congress has empowered them to bring likely will be the required § 16(a) reports.[10] If insiders could insulate their transactions from the scrutiny of outside shareholders by failing to file § 16(a) reports and waiting for the two year time limit to pass, then Congress' creation of these shareholders' derivative suits would be nullified.

This congressional interest in affording individual security holders the opportunity to sue under § 16 militates in favor of the disclosure interpretation over the notice interpretation in another respect. Under the notice interpretation, the question arises whether the knowledge of corporate officers or directors should be attributed to the corporation, thus giving it notice and allowing the limitations period to run. Normally, knowledge of corporate officers is imputed to the corporation. But in the § 16 context, if corporate officials' knowledge of another insider's trading and indeed even the trader insider's own knowledge were imputed to the corporation, then the corporation's right to recover the profits and especially the ability to bring such suits would be seriously impaired. *Cf. Schur v. Salzman*, 365 F.Supp. 725, 733 (S.D.N.Y. 1973); *Jefferson Lake Sulphur Co. v. Walet*, 104 F.Supp. 20, 23 (E.D. La. 1952), *aff'd*, 202 F.2d

[10] The reports are available to the public at the SEC and at the exchanges. 17 C.F.R. § 240.24b-3(a). The information in all the reports is compiled and published by the SEC in a pamphlet available at SEC offices and exchanges and widely distributed by subscription. *See* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1039 & n.9.

433 (5th Cir.), *cert. denied*, 346 U.S. 820, 74 S.Ct. 35, 98 L.Ed. 346 (1953) (corporation's § 16(b) suit is not estopped on ground that corporation approved of transactions, since corporation's action under control of very insiders involved). *See also* Cook & Feldman, *supra*, 66 Harv.L.Rev. at 413-14. Collusion among insiders and, a more likely occurrence, the unarticulated acquiescence in or averting of gaze from a powerful insider's transactions thus would be rewarded under the notice interpretation. This problem does not arise under the disclosure interpretation. Thus, the disclosure interpretation adopted herein better serves the purposes of the statute.

Finally, the purpose of § 16 to impose absolute accountability within clearly demarcated boundaries, supports the disclosure interpretation. This goal of clear boundaries is served by a limitations period which can be mechanically calculated from objective facts. The dates on which purchases and sales are made are such facts, as are the dates on which § 16(a) reports are filed with the SEC. By contrast, under the notice interpretation, the running of the limitations period would depend on uncertain determinations of what knowledge should lead a corporation to discover its cause of action. Thus, the disclosure interpretation better serves the statute's purpose than the notice interpretation.

C. Statutory Analysis and Prior Cases

Only a few cases have considered the two year limitation provision of § 16(b). Three cases from the Southern District of New York agree with our analysis. *See Shattuck Denn Mining Corp. v. La Morte*, [1973-74 Transfer Binder] CCH Fed.Sec.L.Rep. ¶¶ 94,429 at 95,472 (S.D.N.Y. 1974). *Blau v. Albert*, 157 F.Supp. 816 (S.D.N.Y. 1957); *Grossman v. Young*, 72 F.Supp. 375 (S.D.N.Y. 1947). One case from the Middle District of Pennsylvania rejected this analysis and adopted a strict interpretation of the two year limit. *See Carr-*

Consolidated Biscuit Co. v. Moore, 125 F.Supp. 423 (M.D. Pa. 1954).[11] *Grossman v. Young* and *Blau v. Albert* are the better reasoned decisions, and reference is made to them for more elaboration of the disclosure interpretation. *See also* 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1055-58 (discussing the two year limitation, approving *Grossman*, and critizing [*sic*] *Carr-Consolidated Biscuit Co.*).

The court in *Carr-Consolidated Biscuit Co.* relied on the discarded theory that substantive statutes of limitations are entitled to literal application by the courts and may not be tolled. *See* 125 F.Supp. at 429-30. But this theory was effectively renounced by the Supreme Court in *American Pipe and Construction Co. v. Utah*, 414 U.S. 538, 556-59, 94 S.Ct. 756, 767-769, 38 L.Ed.2d 713 (1974). The *Carr-Consolidated Biscuit Co.*, court also relied on a comparision of the limitation provision in § 16(b) with those in other securities statutes—for example, §§ 9(e) and 18(c) of the 1934 Act, 15 U.S.C. §§ 78i(e) and 78r(c), and § 13 of the 1933 Act, 15 U.S.C. § 77m. *See* 125 F.Supp. at 430-31. In those statutes, Congress expressly provided for the operation of limitations periods in other than a strict manner. The court surmised that the absence of an express provision for tolling in § 16(b) necessarily shows congressional intent of a strict interpretation. Urging the strict interpretation, William renews this comparison of statutory provisions argument, citing recent Supreme Court cases in other securities areas using such an analysis. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206-09, 96 S.Ct. 1375, 1387-1388, 47 L.Ed.2d 668 (1976) (various standard-of-liability provisions of

[11] In four other cases, the two year limit, strictly calculated, was held to bar suit or was assumed to be the measure, but in these cases the question of tolling due to failure to file § 16(a) reports was not presented. *See Morales v. Mylan Laboratories, Inc.*, 443 F.Supp. 778 (W.D. Pa. 1978); *Cowsar v. Regional Recreations, Inc.*, 65 F.R.D. 394 (M.D.La. 1974); *Chambliss v. Coca-Cola Bottling Corp.*, 274 F.Supp. 401 (E.D. Tenn. 1967), *aff'd*, 414 F.2d 256 (6th Cir. 1969), *cert. denied*, 397 U.S. 916, 90 S.Ct. 921, 25 L.Ed.2d 97 (1970); *Blau v. Lamb*, 191 F.Supp 906 (S.D.N.Y. 1961).

the 1934 Act must be read together); *Blue Chip Stamps v. Manor Drugs Stores*, 421 U.S. 723, 733-36, 95 S.Ct. 1917, 1924-1926, 44 L.Ed.2d 539 (1975) (various standing-to-sue provisions of the 1934 Act must be read together).

As an approach to statutory construction, this comparative analysis is obviously sound. In this instance, however, the comparison is not so helpful to William's position. First, the light those other provisions may shed on § 16(b) by comparison depends on the clarity of the other provisions in their own right. But the meaning of the other provisions of the 1934 Act, §§ 9(e) and 18(c), is not clear. *See, e. g., Jacobson v. Peat, Marwick, Mitchell & Co.*, 445 F.Supp. 518, 526-27 (S.D.N.Y. 2977) (construing "accrued" in § 18(c)).

Furthermore, the provisions actually appear silent on the question of tolling. They each create a three year limitations period from the time the action accrues but make an additional shorter limit of one year from actual discovery of the facts constituting the action. Indeed, these provisions appear to have a meaning contrary to that advanced by William and *Carr-Consolidated Biscuit Co.* William argues these provisions expressly provide for tolling and therefore the absence of similar congressional expression in § 16(b) is relevatory. But, on their face, these provisions appear provide [*sic*] an absolute three-year maximum, beyond which suit may not be brought regardless of when the facts are discovered. *See, e.g., Bader v. Fleschner*, 463 F.Supp. 976, 981 (S.D.N.Y. 1978). Thus, the absence of similar language creating a maximum time limit in § 16(b) shows that Congress contemplated tolling in appropriate circumstances in § 16(b) cases. We do not decide whether this interpretation of §§ 9(e) and 18(c) is correct. It merely shows that the comparison analysis argument advanced by William is unpersuasive.

Moreover, even if the comparison of § 16(b) with the other provisions were more favorable to William's position, the comparison of statutory provisions analysis would not be

complete until the language of § 16(b)'s limitation provision had been considered in light of the context of all of § 16. As discussed earlier, § 16(b) is interrelated with the congressionally created reporting requirements of § 16(a). Sections 9(e) and 18(c) do not have similar disclosure provisions. Therefore, comparison with them is unhelpful in determining how a disclosure provision interacts with a limitations period.

In summary, we hold that an insider's failure to disclose covered transactions in the required § 16(a) reports tolls the two year limitations period for suits under § 16(b) to recover profits connected with such a non-disclosed transaction.[12] The two-year period for § 16(b) begins to run when the transactions are disclosed in the insider's § 16(a) report. *See Blau v. Albert*, 157 F. Supp. at 819; *Shattuck Denn Mining Corp. v. La Morte*, *supra*. This interpretation is consistent with the legislative scheme of § 16. It is supported by prior cases construing the section and by securities commentators. The district court's result on the limitations issue is therefore reversed.

IV.

PROFIT COMPUTATION METHOD

In calculating the profit realized as a result of William's securities transactions the district court used the "lowest purchase price, highest sale price" method. This method was set forth long ago by the Second Circuit in *Smolowe v. Delendo Corp.*, 136 F.2d 231 (2d Cir.), *cert. denied*, 320 U.S. 751, 64 S.Ct. 56, 88 L.Ed. 446 (1943). Courts appear nearly unanimous in approving the *Smolowe* rule; commentators are also generally in favor, but there are some critics. *See* 2 L. Loss,

[12] We note that the American Law Institute's proposed Federal Securities Code expressly provides for tolling in insider liability recovery while there is violation of the reporting requirement. *See Federal Securities Code* (Proposed Official Draft, March 15, 1978) §§ 605(a) (reporting requirements), 1717 (insider liability), & 1727(d) (statute of limitations and tolling).

Securities Regulation (2d ed. 1961) at 1062-65; 5 L. Loss, *Securities Regulation* (2d ed. Supp. 1969) at 3024-25; Cooke & Feldman, *Insider Trading Under the Securities Exchange Act (Part II)*, 66 Harv.L.Rev. 612, 612-14 (1953). The question of the profit computation method for § 16(b) is one of the first impression in this circuit. The Corporation urges that we adopt the longstanding *Smolowe* rule. William argues the *Smolowe* rule is incorrect and proposes a rule matching sales with purchases closest in time. Persuaded by its merit and its long continued use in other courts, we adopt the *Smolowe* rule.

Under the *Smolowe* rule, the highest sales price is matched with the lowest purchase price in any given six month period.[13] In analyzing the legislative history and the remedial nature of the statute, the court in *Smolowe* concluded:

> The statute is broadly remedial. [citation omitted] Recovery runs not to shareholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty. [citations omitted] The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out—within six months.

Smolowe, 136 F.2d at 239. Eight years later the Second Circuit again considered the profit computation issue and, after an independent analysis, affirmatively reasserted the *Smolowe* doctrine. *Gratz v. Claughton*, 187 F.2d 46, 50-52 (2d Cir.), *cert. denied*, 341 U.S. 920, 71 S.Ct. 741, 95 L.Ed. 1353 (1951) (L. Hand, J.).

---

[13] The operation if [*sic*] the *Smolowe* rule is explained at, *e. g.*, 2 L. Loss, *Securities Regulation* (2d ed. 1961) at 1063 (quoting Rubin & Feldman, *Statutory Inhibitions upon Unfair Use of Corporate Information by Insiders*, 95 U.Pa.L.Rev. 468, 482-83 (1947)).

The Second Circuit continues to adhere to the *Smolowe* rule. *See Feder v. Martin Marietta Corp.*, 406 F.2d 260, 269 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036, 90 S.Ct. 678, 24 L.Ed.2d 281 (1970); *Adler v. Klawans*, 267 F.2d 840, 847-48 (2d Cir. 1959). *Cf. Cummings v. Commissioner*, 506 F.2d 449, 452 (2d Cir. 1974), *cert. denied*, 421 U.S. 913, 95 S.Ct. 1571, 43 L.Ed.2d 779 (1975) (in analysis that insider's repayment of § 16(b) profits is a long term capital loss, court uses *Smolowe* approvingly).

The large majority of profit computation cases expectably are in the Second Circuit and, particularly, in the Southern District of New York. A long series of district court cases there have continued to apply the *Smolowe* rule. *See, e.g., Lewis v. Levinson*, [1978 Transfer Binder] CCH Fed.Sec. L.Rep. ¶ 96,430 (S.D.N.Y. 1978); *Makofsky v. Ultra Dynamics Corp.*, 383 F.Supp. 631, 638-39 (S.D.N.Y. 1974); *Schur v. Salzman*, 365 F.Supp. 725, 730-731 (S.D.N.Y. 1973); *Volk v. Zlotoff*, 318 F.Supp. 864, 865 (S.D.N.Y. 1970).

When the question of profit computation in § 16(b) has arisen in other courts, they too have adopted the *Smolowe* rule of lowest price in, highest price out. *See Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d 736, 742-43 (8th Cir. 1965), *cert. denied*, 382 U.S. 987, 86 S.Ct. 556, 15 L.Ed.2d 475 (1966); *Morales v. Mylan Laboratories, Inc.*, 443 F.Supp. 778, 780 (W.D.Pa. 1978); *Heli-Coil Corp v. Webster*, 222 F.Supp. 831, 837 (D.N.J. 1963), *aff'd as modified on other grounds*, 352 F.2d 156 (3d Cir. 1965); *Arkansas Louisana Gas Co. v. W.R. Stephens Investment Co.*, 141 F.Supp. 841, 847 (W.D. Ark. 1956). *See also Ohio Drill & Tool Co. v. Johnson*, 498 F.2d 186, 194-95 (6th Cir. 1974) (directing *Smolowe* rule be used in profit computation under state insider trading statute).

William cites one case as disapproving the *Smolowe* rule, namely, *Allis-Chalmers Manufacturing Co. v. Gulf & Western Industries, Inc.*, 527 F.2d 335 (7th Cir. 1975), *cert. denied*, 423 U.S. 1078, 96 S.Ct. 865, 47 L.Ed.2d 89 (1976). In *Allis-*

Chalmers, the Seventh Circuit declined to apply the *Smolowe* rule in the case before it. But the court in *Allis-Chalmers* did not reject the *Smolowe* rule; indeed it "agree[d] with the underlying principle of the . . . *Smolowe* case." 527 F.2d at 355. The court distinguished its case from *Smolowe* on the ground that *Smolowe* involved the problem of trade-matching. There were multiple sales and purchases, and some rule had to be adopted to determine how they should be matched for computing profit. But *Allis-Chalmers* involved a question of valuation of the shares and was not a trade-matching case, and so the court did not apply the *Smolowe* rule. *See* 527 F.2d at 354-56. *Cf. Anderson v. Commissioner*, 480 F.2d 1304, 1307 (7th Cir. 1973) (in holding insider's repayment of § 16(b) profits a long term capital loss, Seventh Circuit approvingly cites *Smolowe* rule).

William also maintains the *Smolowe* rule is inconsistent with the legislative history of § 16(b). That the *Smolowe* rule serves the legislative purpose of § 16(b) is amply demonstrated in the previously discussed Second Circuit cases. William's principle argument is a comparison of the original version of § 16(b) with the final result. The original Senate and House versions of what became of § 16(b) provided for a variation of the "lowest in, highest out" method of profit calculation.[14] This language did not appear in the final version enacted into law. William argues this shows congressional rejection of such a method of profit calculation and it is thus improper for the courts to resurrect it.

---

[14] The pertinent language of the earlier bills provided as follows:

> For the purposes of this subsection the profit shall be calculated on the sale or sales by such person of such security made at the highest price or prices and on the purchase or purchases made by such person of such security at the lowest price or prices during the six months' period, irrespective of the certificates for such security received or delivered to such person during such period.

S. 2693, H.R. 7852, 73d Cong., 2d Sess. § 15(b) (1943), *reprinted in* Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (Ellenberger & Mahar ed. 1973).

This argument is without substance. As William concedes in his brief, there is no statement anywhere in the legislative history as to why this language did not appear in the final version. There is no intimation that Congress disapproved of it. William's characterization of what occurred as "congressional rejection" is extreme. If Congress had deleted this language and replaced it with other language describing another method of profit calculation, one might infer that Congress disapproved of the prior language. *Cf. National Automatic Laundry and Cleaning Council v. Shultz*, 443 F.2d 689, 706 (D.C.Cir. 1971) (positive congressional action in rejecting amendments, unlike mere inaction, carries some weight). But all that occurred here is that certain language did not appear in the final version. Statutory interpretation cannot rest safely on mere inaction in Congress; nor can it rest on unexplained changes made in congressional committees. *Federal Trade Commission v. Dean Foods Co.*, 384 U.S. 597, 609-10 & n. 11, 86 S.Ct. 1738, 1745 & n. 11, 16 L.Ed.2d 802 (1966); *Trailmobile Co. v. Whirls*, 331 U.S. 40, 61, 67 S.Ct. 982, 992, 91 L.Ed. 1328 (1947); *United States v. Imperial Irrigation District*, 559 F.2d 509, 535-36 (9th Cir. 1977), *rev'd on other grounds sub nom. Bryant v. Yellen*, ... U.S. ...., 100 S.Ct. 2232, 65 L.Ed.2d 184 (1980). Legislative silence cannot be viewed as an expression of congressional intent. Without some indication in the legislative history of the reasons why this change occurred, it is unwise to infer much from the silence of Congress. *Cf. Scripps-Howard Radio, Inc. v. Federal Communications Commission*, 316 U.S. 4, 11, 62 S.Ct. 875, 86 L.Ed. 1229 (1942) (search for significance in Congress' silence is often the pursuit of a mirage).

Also persuasive is the fact that in the over thirty-five years since *Smolowe* was decided and has been applied, Congress has failed to act to set aside the rule through contrary legislation. We believe the *Smolowe* rule is in accord with the absolute and thoroughgoing nature of liability under § 16(b). This statute is intended to be a deterrent to a type of activity which Congress realized was subject to much abuse. In some cases the *Smolowe*

rule can be criticized for harshness and artificially. But other methods would be equally artificial.[15] The *Smolowe* rule assures full recovery of profits for the corporation. The *Smolowe* rule of matching the lowest purchase price and the highest sale price within six months serves the purpose of § 16(b). Following the unbroken acceptance of this method by other courts, we adopt it as the rule in this circuit. The district court is affirmed on this issue.

V.

PREJUDGMENT INTEREST

Although § 16 says nothing about the recovery of interest one way or the other, prejudgment interest is generally considered a part of § 16(b) recovery. However, its award is not mandatory. *See generally* 5 L. Loss, *Securities Regulation* (2d ed. Supp. 1969) at 3025-27. The allowance of interest is within the discretion of the trial court, but "the granting of such allowance should not follow as a matter of course." *Gold v. Sloan*, 486 F.2d 340, 353 (4th Cir. 1973), *cert. denied*, 419 U.S. 873, 95 S.Ct. 134, 42 L.Ed.2d 112 (1974). Rather, in a § 16(b) case interest "is given in response to considerations of fairness. It is denied when its exaction would be inequitable." *Blau v. Lehman*, 368 U.S. 403, 414, 82 S.Ct. 451, 7 L.Ed.2d 403 (1962). "Whether interest will be awarded is a question of fairness, lying within the court's sound discretion, to be answered by balancing the equities." *Wessel v. Buhler*, 437 F.2d 279, 284 (9th Cir. 1971) (10b-5 case). *Accord Western Auto Supply Co. v. Gamble-Skogmo, Inc.*, 348 F.2d at 744 (§ 16(b) case). A reviewing court will upset the district court's decision

[15] William urges a rule whereby purchases are matched against the immediately preceding or immediately following sales, whichever is higher. A similar proposal, that the matching of shares to be on a last in-first out basis, was rejected in *Lewis v. Levinson* [1978 Transfer Binder] CCH Fed.Sec.L.Rep ¶ 96,430 (S.D.N.Y. 1978).

granting or denying prejudgment interest only if it is so unfair or so inequitable as to require it. *Blau v. Lehman, supra; Blau v. Lamb,* 363 F.2d 507, 528 (2d Cir. 1966), *cert. denied,* 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed.2d 542 (1967).

Among the factors to be considered in weighing the equities is whether the insider acted innocently or knowingly. In many cases, interest had been denied where it was shown the insider acted in good faith. *See, e.g., Gold v. Sloan, supra; Oliff v. Exchange International Corp.,* 449 F.Supp. 1277, 1302 (N.D.Ill. 1978); *Morales v. Gould Investors Trust,* 445 F.Supp. 1144, 1156 (S.D.N.Y. 1977), *aff'd without opinion,* 578 F.2d 1369 (2d Cir. 1978); *Volk v. Zlotoff,* 318 F.Supp. 864, 867 (S.D.N.Y. 1970); *Marquette Cement Mfg. Co. v. Andreas,* 239 F.Supp. 962, 968 (S.D.N.Y. 1965).

These cases do not mandate a requirement of bad faith or willful violation for the award of prejudgment interest; rather, they justify its denial when such factors are absent. In the balancing of equities in these cases, it is not a one-dimensional question of subjective good or bad faith. The type and degree of the insider's inadvertence, the position of the insider in the corporation, and other circumstances of each case are considered. Even when bad faith may have been absent, interest is still sometimes awarded. *See Champion Home Builders Co. v. Jeffress,* 385 F.Supp 245, 250 (E.D.Mich. 1974); *Perfect Photo, Inc. v. Grabb,* 205 F.Supp. 569, 573-74 (E.D. Pa. 1962). *See also Magida v. Continental Can Co.,* 231 F.2d 843, 848 (2d Cir.), *cert. denied,* 351 U.S. 972, 76 S.Ct. 1031, 100 L.Ed. 1490 (1956). *Cf. B.T. Babbitt, Inc. v. Lachner,* 332 F.2d 255, 259 (2d Cir. 1964) (interest awarded without discussion). The insider must show there is an overriding inequity in allowing interest in order to overcome the granting of interest. *Western Auto Supply Co.,* 348 F.2d at 744. The insider's good faith must be shown; bare allegations are not sufficient. *Gold v. Sloan,* 486 F.2d at 353; *Lewis v. Realty Equities Corp.,* 396 F.Supp. 1026, 1034 (S.D.N.Y. 1975).

When an insider repays the corporation promptly upon demand, that has been taken as betokening good faith and justifying denial of interest, especially when the prompt repayment means the corporation has not lost use of the money for a long time. *See Abbe v. Goss*, 411 F.Supp. 923, 926 (S.D.N.Y. 1975); *Lewis v. Wells*, 325 F.Supp. 382, 387 (S.D.N.Y. 1971).

Another factor in balancing the equities is the length of time involved. When there has been substantial delay between transactions and complaint or between complaint and judgment, courts consider who was responsible for the delay an important factor in allowing interest for such periods. *See Gold v. Sloan, supra; Lewis v. Realty Equities Corp.*, 396 F.Supp. at 1034; *Schur v. Salzman*, 365 F.Supp. 725, 734-35 (S.D.N.Y. 1973); *Blau v. Lamb*, 242 F.Supp. 151, 161 (S.D.N.Y. 1965), *aff'd*, 363 F.2d 507, 528 (2d Cir. 1966), *cert. denied*, 385 U.S. 1002, 87 S.Ct. 707, 17 L.Ed.2d 542 (1967). Moreover, a delay can also be a factor in establishing the date from which interest accrues. Normally, interest accrues from the time of the transactions. *See, e. g., Western Auto Supply Co.*, 348 F.2d at 744. But where delay has occurred for which the insider was not responsible, in accommodating the equities some courts have awarded interest to run from the commencement of the suit. *See Champion Home Builders Co. v. Jeffress*, 385 F.Supp at 250; *Schur, supra.* In *Schur* the court particularly distinguished between the pre-complaint delay for which the plaintiff was responsible and the delaying litigation tactics for which the insider defendant was responsible.

In the case at bar, the district court awarded prejudgment interest on the profits recoverable, *i. e.*, those not barred by the district court's ruling on the limitations issue. William argues the district court erroneously applied an absolute rule granting interest instead of weighing the equities. The use of an absolute rule without regard to the equities would be incorrect. But it is not apparent that the district court used an absolute rule. The lower court's opinion on this point may reflect a decision that,

after considering the circumstances of this case, the equities did not tip in favor of departing from the usual objective nature of § 16(b) liability.

But we need not decide this today. Our decisions on liability and the limitations period may result in a larger amount of profit recovery and a longer period of liability. This may have an effect on the balance of equities. Thus we remand the question of prejudgment interest to the district court for reconsideration in light of the foregoing principles. *See Thomas v. Duralite Co., Inc.*, 524 F.2d 577, 589 (3d Cir. 1975) (similar remand of prejudgment interest in 10b-5 case). We express no opinion on whether prejudgment interest is appropriate here. The balancing of equities must be done in light of all the facts and circumstances of the case. In the first instance, that determination is left to the discretion of the district court.

CONCLUSION

We hold today that William is liable under § 16(b) for profits realized in transactions connected with William's trading of shares held in his mother's name. In this result we agree with the district court. However, we also hold that the two-year limitations period of § 16(b) is tolled as long as the insider has not disclosed the transactions on the required § 16(a) reports. Thus, since reports of the transactions in question here were not filed, William's liability is not cut off by the limitation period. We reverse the district court in this regard. Further, we agree with the district court that the *Smolowe* rule for trade-matching to calculate profits is correct. Finally, we remand the award of prejudgment interest to the district court for reconsideration.

AFFIRMED in part; REVERSED and REMANDED for proceedings in accordance with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

BEULAH WHITTAKER AND WILLIAM R. WHITTAKER, *Plaintiffs,* v. WHITTAKER CORPORATION, a California corporation, *Defendants.*	Civil No. 75-2546-LEW OPINION AND ORDER

In this action plaintiffs, William R. Whittaker ("Mr. Whittaker") and Beulah Whittaker ("Mrs. Whittaker"), seek a declaratory judgment of nonliability under the insider trading provisions of § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), to the defendant, Whittaker Corporation ("the Corporation").[1] Procedurally, this action is unique in that plaintiffs have already voluntarily paid to the Corporation the total amount for which the Corporation alleged they were liable, while expressly denying any liability and reserving their right to challenge in this action the enforceability of the Corporation's demand. In an order dated September 10, 1976, the Honorable William Matthew Byrne, Jr., this judge's predecessor in this action, determined that this court did have subject matter jurisdiction over the claims stated by plaintiffs under both 15 U.S.C. § 78aa and 28 U.S.C. § 1331. A copy of Judge Byrne's order is attached as an appendix to this opinion.

PRELIMINARY FACTS

Plaintiff William R. Whittaker, an engineer and inventor, was the founder of a business which started in his backyard and eventually grew into what is now Whittaker Corporation, a New York Stock Exchange Company, which reported sales during its last fiscal year of $660 million. Initially, the business manufactured valves designed by Mr. Whittaker for use in aircraft systems. In order to get his business started in 1943, Mr. Whittaker borrowed $1,800 from his parents for which his parents agreed to take a 35 per cent interest in the venture in lieu of repayment. The business was formally incorporated in 1946.

The business remained relatively small until it was merged with Telecomputing Corporation in 1957. The resulting entity retained the name Telecomputing Corporation until it was changed to Whittaker Corporation in 1964. The merger did not substantially affect the basic size of the organization or the makeup of its management group headed by Mr. Whittaker as President and Chairman of the Board of Directors.

The officers and directors of Whittaker Corporation first became subject to the insiders' reporting requirements of § 16(a) of the Securities Exchange Act of 1934 in March 1965, as a result of the broadening of § 16(a)'s coverage in the 1964 amendments to the Act.

It was about this time that the Corporation began to experience a period of rapid growth. Supervision of the growth activity and of the management reorganization took up all of Mr. Whittaker's time and effort. Accordingly, the responsibility of assuring that the Corporation and its officers and directors complied with the newly applicable federal reporting requirements was delegated to the Corporation's legal counsel, Mr. Bertin Weyl. In

March 1965, Mr. Weyl prepared the initial reports (referred to as Forms 3) for signature by each of the Corporation's officers and directors, including Mr. Whittaker. Thereafter, any reports showing subsequent ownership changes (referred to as Forms 4) were prepared by the Corporation's legal department. Mr. Whittaker relied upon the legal department (1) to advise him when a report was due; (2) to obtain the necessary information concerning his trading in Whittaker Corporation securities; (3) to prepare the necessary forms for his signature; and (4) to see that they were filed on time with the Securities Exchange Commission. This procedure was established as part of an overall program by which the Corporation undertook to keep its officers and directors advised as to their duties under the federal securities laws. In connection therewith, the Corporation's legal department prepared numerous legal memoranda for distribution to all affected personnel to inform them concerning their responsibilities and any changes therein.

The instant litigation arises out of certain insider transactions in the equity securities of defendant by Mr. Whittaker on behalf of both himself and his mother, Beulah Whittaker, between December 1, 1965 and December 31, 1970 ("the relevant trading period"). Defendant asserts that due to the unique relationship between Mr. Whittaker and his mother, Mr. Whittaker must be considered the beneficial owner of any Whittaker Corporation securities he purchased or sold in her behalf. As a result of this, the defendant asserts that plaintiffs incurred liability under § 16(b) of the Securities Exchange Act of 1934. The concept of beneficial ownership under the Act will be discussed shortly; however, as a background, it is first necessary to describe the relationship between Mr. Whittaker and his mother.

Mrs. Whittaker was born in 1887 and is presently 89 years of age. At no time has she personally been an officer or director of the Corporation. In 1959, because of her advancing age and concern about the management of her estate, Mrs. Whittaker granted to her son a broad general power of attorney, giving him the right to pay her bills, to sign checks on her behalf, to purchase and sell securities for her investments, financial and business affairs. In 1969, that power of attorney was renewed in identical terms. At all times relevant to this litigation, Mr. Whittaker made and executed virtually all investment and business decisions for his mother on his own initiative and in his sole discretion pursuant to this power of attorney.

Under the terms of Mrs. Whittaker's will, executed in 1963 and unrevised since that date, her son is the sole beneficiary. Should the will be invalid for any reason, Mr. Whittaker is also his mother's exclusive legal heir.

Substantially all of Mrs. Whittaker's bills are paid out of a joint bank checking account bearing her name and the name of her son. From approximately the spring of 1960, and throughout the relevant trading period, Mr. Whittaker maintained and personally signed all checks drawn on this joint account. During the same relevant period, all of Mrs. Whittaker's income was deposited in the joint account and all of her expenses were paid out of it.

Since at least 1960, Mr. Whittaker and Mrs. Whittaker have frequently advanced substantial loans to each other. Mr. Whittaker has periodically made noninterest bearing loans of money to his mother which have ranged in amount from approximately $2,000 to $20,000. These loans were made to enable Mrs. Whittaker to meet her regular living expenses while she awaited receipt of interest and dividend payments from her corporate in-

vestments. Commencing in January 1962, and throughout the relevant trading period, Mr. Whittaker received a series of substantial loans from his mother. Mr. Whittaker's present total indebtedness to his mother is approximately $767,436.00, a figure which represents more than half of the present market value of Mrs. Whittaker's estate. The vast majority of Mr. Whittaker's loans from his mother were used to finance Mr. Whittaker's purchase of common stock in the Corporation from Mrs. Whittaker. Although a number of the initial loans to him were evidenced by interest bearing notes, Mr. Whittaker actually paid to his mother only a very small fraction of the interest due under these obligations. The loans were originally secured by substantial pledges of common stock owned by Mr. Whittaker, but this pledged stock was periodically reconveyed to Mr. Whittaker by his mother without substituting alternative security.

In November of 1973, Mr. Whittaker consolidated his indebtedness to his mother by executing a note in her favor in the amount of $727,436.00. At the time this note was executed, Mrs. Whittaker was 86 years of age. The note was payable within ten years, bore no interest and was subordinated to other secured and unsecured bank loans owed by Mr. Whittaker. No part of the earned, but unpaid, interest accrued under previous notes was added to the principal amount of this November 1973 note. To date, no part of the principal due under this note, or under any of its predecessors, has been paid by Mr. Whittaker to his mother.

The securities transactions which give rise to the instant action took place between December 1, 1965 and December 31, 1970. During this period, Mr. Whittaker purchased on his own initiative registered common stock and convertible debentures of Whittaker Corporation for

his mother's account, and within six months of such purchases, he sold common stock for his own account and convertible debentures for his mother's account. All of the transactions on behalf of his mother were effected in his own initiative pursuant to his power of attorney.

The Corporation asserts that it did not learn of the existence of Mr. Whittaker's broad power of attorney until the fall of 1970. Thereafter, an investigation was conducted of all transactions entered into by Mr. Whittaker in the equity securities of the Corporation pursuant to this power of attorney. After a schedule of these transactions and Mr. Whittaker's personal transactions in the Corporation's securities was compiled, a liability was asserted by the Corporation against Mr. Whittaker and Mrs. Whittaker in the amount of $495,222.12.[2] As noted at the outset, Mr. Whittaker voluntarily paid this amount while expressly denying any liability and reserving the right to bring this action.

THE ISSUE OF BENEFICIAL OWNERSHIP

The threshold issue which this court must determine is whether Mr. Whittaker exercised control over his mother's affairs sufficient to find that he was in fact the beneficial owner of any securities he purchased on her behalf. The term "beneficial owner" is defined in § 16(a) of the Securities Exchange Act of 1934, which section requires corporate insiders file a statement of beneficial ownership with the Securities Exchange Commission. This section provides in pertinent part:

> "Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 781 of this title, or who is a director or an officer of the issuer of such security, shall file . . . a statment with the Commission

. . . of the amount of all equity securities of such issuer of which he is the beneficial owner . . . ."

In a release dated January 19, 1966, the Securities Exchange Commission attempted to clarify the meaning of "beneficial ownership." This release provides in relevant part:

"Generally a person is regarded as the beneficial owner of securities held in the name of his or her spouse and their minor children. Absent special circumstances such relationship ordinarily results in such person obtaining benefits substantially equivalent to ownership, e.g., application of the income derived from such securities to maintain a common home, to meet expenses which such person otherwise would meet from other sources, or the ability to exercise a controlling influence over the purchase, sale, or voting of such securities. Accordingly, a person ordinarily should include in his reports filed pursuant to Section 16(a) securities held in the name of a spouse or minor children as being beneficially owned by him.

"A person also may be regarded as the beneficial owner of securities held in the name of another person, if by reason of any contract, understanding, relationship, agreement, or other arrangement, he obtains therefrom benefits substantially equivalent to those of ownership.

• • • •

"A person is also regarded as the beneficial owner of securities held in the name of a spouse, minor children or other person, even though he does not obtain therefrom the aforementioned benefits of ownership, if he can vest or revest title in himself at once, or at some future time." Sec. Ex. Act Rel. 7793, 31, F.R. 1005 (1966).

The Commission thus set forth a dual test of beneficial ownership. First, a person may be regarded as a beneficial owner of another's securities if he obtains "benefits substantially equivalent to those of ownership," or secondly, even though he does not obtain such benefits, "he can vest or revest title in himself at once, or at some future time." It is to be noted, however, that the Commission issued a subsequent release indicating that the reporting requirements of § 16(a) are not coextensive with liability under § 16(b), which was to be determined upon the particular facts of each case. Sec. Ex. Act Rel. 7824, 31 F.R. 3175 (1966).

Nevertheless, these alternative tests were recently applied in a case arising out of the Second Circuit to determine whether a corporate insider had "realized profit" within the meaning of § 16(b) as a result of matching his wife's sales within the statutory six-month period. *Whiting* v. *Dow Chemical Company*, 386 F.Supp. 1130 (S.D.N.Y. 1974), aff'd, 523 F.2d 680 (2nd Cir. 1975). In affirming the attribution of Mrs. Whiting's stock transactions to her husband, the Second Circuit specifically applied the "benefit or control" test noting that "in a statute (§ 16(b)) intended to be simple and arbitrary in its application, we confront a situation that cannot be resolved by legal interpretation but which requires a determination of questions of fact." Id at 687.

In the instant action, plaintiffs have argued strenuously that the language of § 16(b), which refers to profits "realized by him" (i.e. the insider), is to be interpreted strictly in view of the four Supreme Court decisions that have dealt with the section. *See Blau* v. *Lehman*, 368 U.S. 403, 82 S.Ct. 451 (1962); *Reliance Electric Company* v. *Emerson Electric Company*, 404 U.S. 418, 92 S.Ct. 596 (1972); *Kern County Land Company* v. *Occidental Petroleum Corporation*, 411 U.S. 582, 93 S.Ct. 1736 (1973);

Foremost-McKesson, Inc. v. *Provident Securities Company*, 423 U.S. 232, 96 S.Ct. 508 (1976). This court declines to read § 16(b) in such a narrow fashion and is of the opinion that the above cited Supreme Court decisions do not dictate such a narrow view, for as noted by one court "[s]ubdivisions (a) and (b) of Section 16 are grammatically interrelated and must, therefore, be read together for coherence." *American Standard, Inc.* v. *Crane Co.*, 510 F.2d 1043, 1058 (2nd Cir. 1974), *cert. denied*, 421 U.S. 1000, 95 S.Ct. 2397 (1975). Similarly, the Supreme Court noted in *Foremost-McKesson, Inc.* v. *Provident Securities Company, supra*, that the court must look to § 16(a) of the Act to determine the identity of corporate "insiders" whose trading is regulated by § 16(b). Id. at 234, fn. 1, 96 S.Ct. at 511.

This court thus accepts the premise that the term "beneficial owner" as used in § 16(b) of the Act must be read in a broader fashion than as referring merely to a 10 per cent stock owner. This was clearly the position taken by the Second Circuit in *Whiting, supra*, wherein the court noted:

> "While in § 16(b), the liability section, the term 'beneficial owner' apparently refers to a 10% owner as distinguished from a director or officer, and there is no further reference in that subsection to 'beneficial owner' as an equitable owner, as well as a 10% owner, we read 'such beneficial owner' to include both meanings." Id. at 685, fn. 7.

Mr. Whittaker nevertheless argues that he cannot be held liable under § 16(b) because no profit was realized "by him." Once again, this issue was faced squarely in *Whiting, supra*, and this court chooses to follow the logic of that court's decision. In relevant part, the court stated:

"In so interpreting 'beneficial owner' we are not 'adding' to the prophylactic effect Congress itself clearly prescribed in § 16(b). [Citation] Prophylaxis is meant to prevent rather than to cure what has already happened.

"If, then, appellant is 'the beneficial owner' of his wife's securities of the issuer for § 16(b) purposes, how does one interpret the statutory language of § 16(b) 'any profit realized by *him*' (emphasis added).

"If we hold that he is a 'beneficial owner' he must be chargeable with all the profits or none, in the absence of a way to measure benefit. [Citation] It is fiction, of course, to say that he will get all the profit for himself, but here the prophylaxis comes in. The whole profit is 'his' profit, 'realized by him' because the shares are 'his' by the statutory 'beneficial owner' concept as applied, and because he is a person in a position to obtain inside information." Id at 689.

In sum, this court adopts the reasoning set forth in *Whiting, supra*, and concludes that "beneficial ownership" is a factual issue which must be determined in this case. *See also: Altamil Corporation* v. *Pryor*, 405 F.Supp. 1222 (S.D. Ind. 1975).

Turning to the facts in this case, it is clear that Mr. Whittaker exercised virtually complete control over his mother's affairs and must be deemed the beneficial owner of her Whittaker Corporation securities for purposes of § 16(b).

The evidence shows quite clearly that by virtue of the power of attorney executed by his mother, Mr. Whittaker exercised complete control over her financial affairs. This enabled Mr. Whittaker to freely borrow large sums of money from her while never having to consider paying the money back, posting adequate security or even paying

any interest that might accrue. The most recent note executed by Mr. Whittaker, while outside the relevant trading period, is proof positive on this point. Executed in 1973 when Mrs. Whittaker was 86 years old, the note was executed in the amount of $727,430, bore no interest, was payable within ten years and was not backed by any pledge of collateral. The record reflects that similar notes were executed by Mr. Whittaker during the relevant trading period.

Additionally, the record reflects that Mr. Whittaker employed his mother's assets to fund, through interest-free loans, advantageous investment opportunities he might otherwise have been forced to forego. For example, it appears that on at least three occasions Mr. Whittaker took out loans from Security Pacific National Bank in his mother's name. Mrs. Whittaker paid all of the interest due under these loans from the bank. During the same period, Mr. Whittaker himself paid no principal or interest to his mother on the amounts she had loaned him. In short, the evidence indicates that Mr. Whittaker felt free to utilize his mother's assets exactly as if they were his own. It is thus obvious that Mr. Whittaker stood to gain on any profits he might make for his mother through the purchase and sale of Whittaker Corporation securities.

This conclusion is supported further by virtue of the fact that Mr. Whittaker is the sole beneficiary named in his mother's will as well as his mother's exclusive legal heir. During the relevant trading period, Mrs. Whittaker was between 79 and 83 years of age and was in relatively poor health. She was largely incapable of managing her own business and household affairs and Mr. Whittaker testified that by 1964 she was forgetful and suffered severe lapses of memory. In light of these circumstances, this court concludes that it was quite unlikely that Mrs.

Whittaker would have sought to change her will and questions whether she even had the legal capacity to do so.

All of these factors point sharply to the conclusion that Mr. Whittaker did in fact enjoy "benefits substantially equivalent to those of ownership." Within the language of Securities Exchange Act Release 7793, *supra*, Mr. Whittaker did in fact exercise a controlling influence over the purchase, sale and voting of his mother's Whittaker Corporation securities. The power of attorney exercised by Mr. Whittaker allowed him unfettered control over his mother's affairs and under these circumstances it would be absurd for this court to reach the conclusion that Mr. Whittaker's trading on behalf of his mother was not in fact done for his own benefit. Such a result would in effect sanction the kind of insider trading Congress so clearly sought to prevent through the enactment of § 16(b). Accordingly, this court finds that Mr. Whittaker was in fact the beneficial owner of any Whittaker Corporation securities he purchased or sold on behalf of his mother. Hence, plaintiffs are liable under § 16(b).

APPLICABLE TRADE-MATCHING RULE

Rather remarkably, the Ninth Circuit has never passed upon the proper rule to apply in computing the profits realized under § 16(b). Defendant strongly urges this court to adopt the rule set forth long ago by the Second Circuit in *Smolowe* v. *Delendo Corporation*, 136 F.2d 231 (2nd Cir. 1943), *cert. denied*, 320 U.S. 751, 64 S.Ct. 56 (1943). Under this rule, the highest sale price is matched with the lowest purchase price in any given six-month period. In analyzing the legislative history as well as the remedial nature of the statute, the court in *Smolowe* reached the following conclusion:

"The staute is broadly remedial. [Citation] Recovery runs not to the stockholder, but to the corporation. We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty. [Citations] The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out — within six months — as applied by the district court. We affirm it here, defendants having failed to suggest another more reasonable rule." Id. at 239.

Plaintiffs oppose the application of the *Smolowe* rule in the present case, asserting that it leads to "illogical and unfair" results. Plaintiffs instead propose a different rule which might be referred to as a "contiguous time rule." As set out in their Trial Memorandum at 64-65, plaintiffs' proposed rule is stated as follows:

"Against the purchase within the trading period at the lowest price, match the sale most immediately either preceding or following it which was at the higher price. If the matched sale involved a lesser number of shares than the number purchased, match against the unmatched part of the purchase, the sale next most immediately preceding or following it which was at the higher price. Repeat the process until all the shares purchased at the lowest price have been matched against sales contiguous in time. Repeat the process for all other purchases, taking them in order from lowest to highest price. No sale may be matched against a purchase unless there were no other sales intervening in time between such sale and purchase, which intervening sales previously have not been matched against the purchase. All subsidiary rules applicable under

Smolowe also pertain: No purchase or sale may be matched more than once; no sale may be matched against a purchase unless it preceded or followed such purchase by less than six months; any purchase which, if matched against either of the sales contiguous in time, would produce a loss may be disregarded; and losses in one matched set of purchase and contiguous sale or sales may not offset profit in other matched sets."

This question being an issue of first impression in this circuit, this court elects to apply the *Smolowe* rule in this case. This rule has been followed for many years in the Second Circuit and it was reaffirmed in a subsequent case even though the court recognized that the rule's application could lead to some illogical results. See *Gratz* v. *Claughton*, 187 F.2d 46 (2nd Cir. 1951), *cert. denied*, 341 U.S. 920, 71 S.Ct. 741 (1951).[3] The rule has additionally been followed in the Eighth Circuit. *See Western Auto Supply Company* v. *Gamble-Skogmo, Inc.*, 348 F.2d 736 (8th Cir. 1965), *cert. denied*, 382 U.S. 987, 86 S.Ct. 556 (1966). Even more persuasive, however, is the fact that in the over thirty years since *Smolowe* was decided, Congress has failed to act to set aside the rule through contrary legislation. In short, this court is of the opinion that the *Smolowe* rule is in accord with the absolute and thoroughgoing nature of liability under §16(b). This statute is intended to be a deterrent to a type of activity which Congress realized was subject to much abuse, and, while in some cases the rule's application might result in harsh penalties, there does not appear to be any better way to determine the profits realized. In situations such as the one at bar, the court is being asked to compare apples (Mr. Whittaker's sales) and oranges (Mrs. Whittaker's purchases). In such an instance, there is simply no unarbitrary way in which to compute the "profit" realized.

TOLLING OF THE APPLICABLE STATUTE OF LIMITATIONS

Section 16(b) specifically provides that no action under the section "shall be brought more than two years after the date such profit was realized." In the instant case, payment was made voluntarily by Mr. Whittaker on January 29, 1971. This date thus becomes the applicable date from which the statute of limitations, if applicable, is measured. If the two-year period is applicable, then the Corporation will be limited to recovery of profits realized only after January 29, 1969.

The Corporation argues that the two-year statute was tolled by virtue of the fact that Mr. Whittaker failed to file reports as to his mother's purchases as required by § 16(a) of the Act. The statute was thus tolled because defendant had no way of knowing of the mother's purchases. In support of this tolling proposition, defendant cites *Grossman* v. *Young*, 72 F.Supp. 375 (S.D.N.Y. 1947), wherein the court applied a general statute of limitations principle enunciated by the Supreme Court in *Holmberg* v. *Armbrecht*, 327 U.S. 392, 66 S.Ct. 582 (1946). In *Holmberg*, the court had stated the old equity rule that where a party is victimized by fraud, the statute of limitations does not begin to run until that party discovers the fraud. The court then reiterated that the doctrine is read into every federal statute of limitation. Id. at 397, 66 S.Ct. at 585.

On the other hand, plaintiffs again argue that the statute is to be read strictly, and that the two-year period is applicable and cannot be tolled. In support of this proposition, plaintiffs rely upon *Carr-Consolidated Biscuit Company* v. *Moore*, 125 F.Supp. 423 (M.D. Pa. 1954). In that case, the district court held that the statute means exactly what it says and strictly applied the statute to prevent tolling. Id. at 432.

While this tolling issue is again a question of first impression within this circuit, this court finds that, given the facts of this case, it need not resolve the issue. Based on the evidence presented at trial, this court is able to conclude that the Corporation was on notice during the relevant trading period of Mr. Whittaker's trading in Whittaker Corporation securities on behalf of both himself and his mother. The Corporation was thus on notice of any potential § 16(b) claim.

The testimony elicited at trial indicates that Mr. Whittaker was a man who was very open about his affairs in general, and it appears to have been common knowledge among the corporate officers that he frequently sold Whittaker Corporation securities.[4] It was additionally well known that during the relevant trading period Mr. Whittaker was buying and selling Whittaker equity securities for his mother.[5] Even more telling is the fact that copies of all trades made by Mr. Whittaker on behalf of both himself and his mother were sent to Mr. Frank Buhlman, Treasurer of the Corporation, so that he could prepare their income tax returns.[6] Mr. Buhlman thus had direct access to all records pertinent to the transactions of Mr. Whittaker and Mrs. Whittaker.

Further, the evidence is conclusive that various officers in the Corporation knew about the complete power of attorney that Mrs. Whittaker had executed in favor of her son. Mr. Whittaker himself testified that Mr. Bertin Weyl, Chief Counsel for the Corporation, knew about the power of attorney,[7] as did Mr. Buhlman, and Mr. Andrew J. Chitiea, who served as a director of Whittaker Corporation and Vice President of Finance.[8] Miss Ellen Kubo, who was Mr. Whittaker's secretary, testified that she believed Messrs. Weyl, Chitiea, and Joseph Kleiman, a corporate vice president, also knew about the power of attorney.[9] While Mr. Buhlman did not recall knowing

about the power of attorney,[10] and Messrs. Chitiea and Kleiman testified that they had not known of the power of attorney prior to the time the Corporation asserted its § 16(b) claim,[11] the record does show that the Corporation had sufficient information to put it on notice of a potential § 16(b) claim.

This conclusion is strengthened by virtue of two additional facts. First, throughout the trading period Mr. Whittaker used the power of attorney to sign his mother's proxy cards and, at least on some occasions, returned these cards to the Corporation's legal department, occasionally delivering them directly to Mr. Weyl and at least once to Mr. Alan D. Jacobson who became the Corporation's assistant general counsel in 1969 and general counsel in 1971.[12] And secondly, the Corporation conducted a very careful program for the monitoring of all filings by its officers and directors as required under § 16(a) of the Act, making sure that the forms were complete and correct.[13]

All in all, considering the totality of the evidence, this court must conclude that the corporation possessed sufficient information to put it on notice of any potential § 16(b) claim. Accordingly, this court finds that any cause of action accruing to defendant prior to January 29, 1969, is barred by the two-year statute of limitations contained in § 16(b).

PREJUDGMENT INTEREST

The United States Supreme Court considered the issue of prejudgment interest under § 16(b) for the first time in *Blau* v. *Lehman, supra.* Although the court indicated that interest was an accepted element of compensatory damages, its exaction or denial was within the sound discretion of the court. Id. 368 U.S. at 414, 82 S.Ct. at 457. The opinion contained the following limited statement:

"Section 16(b) says nothing about interest one way or the other. This court has said in a kindred situation that 'interest is not recovered according to a rigid theory of compensation for money withheld, but is given in response to considerations of fairness. It is denied when its exaction would be inequitable.' *Board of Commissioners of Jackson County, Kansas* v. *United States*, 308 U.S. 343, 352, 60 S.Ct. 285, 289 (1932)." Id. at 414, 82 S.Ct. at 457.

It appears that some courts have denied prejudgment interest where the insider's violation of the statute was not willful. *See e.g., Lewis* v. *Realty Equity Corporation of New York*, 396 F.Supp. 1026, 1034 (S.D.N.Y. 1975); *Marquette Cement Manufacturing Company* v. *Andreas*, 239 F.Supp. 962, 968 (S.D.N.Y. 1965). However, this view does not comport with the objective nature of liability imposed under § 16(b) and other courts have determined that the imposition of interest should not depend upon the subjective intent of the insider. For example, in *Perfect Photo, Inc.* v. *Grabb*, 205 F.Supp. 569 (E.D. Pa. 1962), the court stated:

"The statutory proscription is absolute, and liability is fastened on the officer or director without any showing of actual use of inside information. In thus creating absolute liability on the part of 'insiders' for 'short swing' profits and abolishing the need for actual abuse of trust, Congress surely did not intend that the corporation should be required to enter upon such proof on the subordinate question of interest." Id at 573.

See also: Western Auto Supply Company v. *Gamble-Skogmo, Inc., supra*, at 744; *Champion Home Builders* v. *Jeffries*, 385 F.Supp. 245, 250 (E.D. Mich. 1974); *Schur* v. *Salzman*, 365 F.Supp. 725, 734 (S.D.N.Y. 1973).

This court is in agreement with the objective standard expressed in these cases and accordingly holds that the

award of prejudgment interest under § 16(b) is not dependent upon the subjective interest or innocence of the insider. Section 16(b) is absolute in its application, and having previously found that Mr. Whittaker is liable as the beneficial owner of his mother's securities, it follows that the Corporation was denied the use of any "profits" realized by Mr. Whittaker. The Corporation is thus entitled to prejudgment interest on these "profits."

CONCLUSION

Specific findings of fact and conclusions of law are incorporated herein as authorized by Rule 52, Federal Rules of Civil Procedure. Judgment is hereby entered for plaintiffs in a sum to be determined by counsel in accordance with this opinion. Counsel for plaintiffs are directed to prepare a form of judgment pursuant to Rule 7 of the Local Rules of this Court.

DATED: March 22, 1977.

LAUGHLIN E. WATERS
United States District Judge

FOOTNOTES

[1]Section 16(b), 15 U.S.C. § 78p(b), reads in full:

"For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

[2]Of this amount, $62,622.11 represents prejudgment interest on the "profit" assessed against him. The Corporation apparently later recalculated the interest due with the result that on September 30, 1976, it refunded to Mr. Whittaker the sum of $4,243.31, together with interest thereon at the agreed upon rate ($1,796.31).

[3]In *Gratz, supra*, liability was imposed even though it was impossible to calculate the defendant's profits. In writing the opinion for the court, Judge Learned Hand observed:

"Although it is impossible in the case at bar to compute the defendant's profits, except that they must fall between two limits – the minimum and the maximum – the cause of this uncertainty is the number of transactions within six months: that is, the number of defendant's derelictions. The situation falls within the doctrine which has been law since the days of the 'Chimney Sweeper's Jewel Case,' [*Armory v. Delamirie*, 1 Strange 505 (1722)] that when damages are at some unascertainable amount below an upper limit and when the uncertainty arises from the defendant's wrong, the upper limit will be taken as the proper amount." Id. at 51-52.

[4]See testimony of Andrew J. Chitiea, who served as a director of Whittaker Corporation and was Vice President of Finance, Reporter's Transcript ("R.T."), pp. 300, 306; testimony of Charles R. Collins, Vice President and General Counsel, R.T. 604.

[5]See Chitiea testimony, R.T. 296, 305-06.

[6]See testimony of William R. Whittaker, R.T. 217; testimony of Frank Buhlman, R.T. 404-406; testimony of Ellen Kubo, R.T. 419-420, 422-24.

[7]R.T. 99.

[8]R.T. 216-17.

[9]R.T. 454-55.

[10]R.T. 408.

[11]R.T. 307, 693.

[12]See testimony of William R. Whittaker, R.T. 69-70, 350-52; testimony of Ellen Kubo, R.T. 421-22.

[13]See testimony of Charles R. Collins, R.T. 593-96.

APPENDIX

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

BEULAH WHITTAKER and
WILLIAM R. WHITTAKER,
Plaintiffs,

vs.

WHITTAKER CORPORATION, a
California corporation,
Defendant.

CV NO. 75-2546-WMB
ORDER

Both plaintiff and defendant have filed motions seeking an affirmative determination as to whether this court has jurisdiction over the subject matter of the claims asserted in the First Amended Complaint. Both parties submitted memorandum urging that the court has subject matter jurisdiction.

The first principle of federal jurisdiction is that "the judicial power of the United States must not be exerted in a case to which it does not extend, even if both parties desire to have it exerted." *Mansfield, Coldwater, & Lake Michigan Ry.* v. *Swan*, 111 U.S. 379 (1884). The parties cannot waive jurisdictional defects and this court is required to independently determine the question of federal jurisdiction.

The question of subject matter jurisdiction is raised because this case arises from a somewhat unusual fact situation. In January of 1971 defendant Whittaker Cor-

poration learned that one of its principal officers and directors, William R. Whittaker, had engaged in certain transactions in the corporation's equity securities between 1965 and 1971. The transactions were undertaken on behalf of Mr. Whittaker's mother pursuant to a general power of attorney held by Mr. Whittaker. Upon learning of these purchases and sales, defendant Whittaker Corporation asserted that such transactions had created "profits" of some $495,222.12 which were recoverable by the corporation under Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. 378p(6). Mr. Whittaker denied that he and his mother had violated the statute or owed any money to the corporation. Nevertheless, the Whittakers paid to the corporation the entire disputed amount in consideration for which the corporation agreed to refund to the Whittakers any amount which a court determined was not owed by the Whittakers to the corporation.

Thus, this case does not arise in the usual manner involving alleged violations of Section 16(b). It is not an action for the recovery of short swing profits filed by the corporation or by the Shareholders in a derivative action over which this court has exclusive jurisdiction by virtue of § 27 of the Act (15 U.S.C. § 78aa). *Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied* 347 U.S. 1016 (1954); *Bath Industries, Inc. v. Blot*, 305 F.Supp. 526, 535 (E.D. Wis. 1969) *aff'd* 427 F.2d 97 (7th Cir. 1970). Here, the plaintiffs seek a judgment declaring that they were not liable to the corporation under Section 16(b) for profits allegedly realized by them on certain sales and purchases of the corporation's equity securities between 1965 and January 19, 1971. In addition, plaintiff seeks an order for the return of the $495,222.12 paid to the corporation on account of the alleged violations.

The plaintiffs in their First Amended Complaint, and both parties in their memoranda, assert that this court has subject matter jurisdiction under Section 27 of the Securities and Exchange Act of 1934 (15 U.S.C. § 78aa) and under 28 U.S.C. § 1331.

Section 27 provides that federal courts have:

> "exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder."

As noted above, this is not an action brought "to enforce any liability or duty created by this chapter." Thus it does not fall within the precise terms of the jurisdictional grant of Section 27. However, in *Whiting v. Dow Chemical Co.*, 386 F.Supp. 1130 (S.D.N.Y. 1974) *aff'd* 523 F.2d 680 (2d Cir. 1975), the court held that Section 27 encompasses an action brought by a corporate insider for a declaration that he was not liable to his corporation for alleged violation of Section 16(b). The Whittakers also seek such a declaration. The fact that the disputed profits have been paid to the corporation prior to institution of the action is a distinction which has no bearing on the jurisdiction of this court. The manifest intent of Congress in Section 27 was that federal courts have exclusive jurisdiction over violations of the federal securities laws and over all suits for the enforcement of any liability or duty created by such law. To deny a federal forum merely because a corporate insider has made a conditional payment of alleged "short swing profits" would violate the clear intent of Congress. To hold otherwise would also allow an insider in a different setting to evade exclusive federal jurisdiction by repaying the "short swing profits" and seeking restitution in the state courts.

The court also has jurisdiction under 28 U.S.C. § 1331 because this case arises under federal law. The plaintiffs upon the face of the complaint have stated a claim based upon federal not state law. *See, Shareholder's Management Co.* v. *Gregory,* 499 F.2d 326 (9th Cir. 1971). *Cf. Pan American Petroleum Corp.* v. *Superior Court,* 366 U.S. 656 (1961). The determination of the claims of plaintiffs depend upon the interpretation of Section 16(b). Such interpretation is pivotal to the resolution of this case. The claims of plaintiffs will be supported if Section 16(b) is given one interpretation and defeated if the section is interpreted differently. Under these circumstances, this case arises under federal law within the meaning of 28 U.S.C. § 1331. *See, Gully* v. *First National Bank of Meridan,* 299 U.S. 109, 112-13 (1936); *T. B. Harms Co. v. Eliscu,* 339 F.2d 823 (2d Cir. 1964).

Accordingly, the Court finds that it has subject matter jurisdiction over the claims stated by plaintiffs in their First Amended Complaint under both 15 U.S. C. § 78aa and 28 U.S.C. § 1331.

Dated: September 10, 1976

WM. MATTHEW BYRNE, JR.
United States District Judge

APPENDIX C

CONTROLLING PROCEDURAL RULES

FED. R. APP. P. 4(a)

Appeals in Civil Cases

(1) In a civil case in which an appeal is permitted by law as of right from a district court to a court of appeals the notice of appeal required by Rule 3 shall be filed with the clerk of the district court within 30 days after the date of entry of the judgment or order appealed from; but if the United States or an officer or agency thereof is a party, the notice of appeal may be filed by any party within 60 days after such entry. . . .

. . . .

(4) If a timely motion under the Federal Rules of Civil Procedure is filed in the district court by any party: (i) for judgment under Rule 50(b); (ii) under Rule 52(b) to amend or make additional findings of fact, whether or not an alteration of the judgment would be required if the motion is granted; (iii) under Rule 59 to alter or amend the judgment; or (iv) under Rule 59 for a new trial, the time for appeal for all parties shall run from the entry of the order denying a new trial or granting or denying any other such motion. . . .

. . . .

FED. R. CIV. P. 54(d)

Costs. Except when express provision therefor is made either in a statute of the United States or in these rules, costs shall be allowed as of course to the prevailing party unless the court otherwise directs; but costs against the United States, its officers, and agencies shall be imposed only to the extent permitted by law. Costs may be taxed by the clerk on one day's notice. On motion served within 5 days thereafter, the action of the clerk may be reviewed by the court.

FED. R. CIV. P. 59(e)

Motion to Alter or Amend a Judgment. A motion to alter or amend the judgment shall be served not later than 10 days after entry of the judgment.

CONTROLLING STATUTES

SECTION 16(a) OF THE SECURITIES EXCHANGE ACT OF 1934 (15 U.S.C. §§ 78p(a))

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 12 of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 12(g) of this title or within ten days after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

SECTION 16(b) OF THE SECURITIES EXCHANGE ACT OF 1934 (15 U.S.C. §§ 78p(b))

(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.